

PROPOSED RICO REFORM LEGISLATION

HEARINGS

BEFORE THE

COMMITTEE ON THE JUDICIARY

UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 1523

A BILL TO AMEND CHAPTER 96 OF TITLE 18, UNITED STATES CODE

OCTOBER 29 AND NOVEMBER 10, 1987

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PROPOSED RICO REFORM LEGISLATION—S. 1523

THURSDAY, OCTOBER 29, 1987

U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The committee met, pursuant to notice, at 2:22 p.m., in room SD-226, Dirksen Senate Office Building, Hon. Howard Metzenbaum presiding.

Also present: Senator DeConcini.

Senator METZENBAUM. The hearing will come to order. The Chair acknowledges that he wanted to hear the President make his warm and enthusiastic remarks concerning his new appointment and so I stayed and watched the TV.

This is a hearing on S. 1523 to reform RICO. RICO, the Racketeer Influenced and Corrupt Organizations Act, has had a checkered history since it was passed in 1970. It has served as a strong and effective tool against organized crime and criminal fraud.

On the other hand, the lure of automatic treble damages and the broad standards for liability have made RICO an overused claim in too many cases of routine business litigation.

The debate over RICO reform has raged inside and outside Congress for the last several years. About a year ago, I directed my staff to meet with interested parties—businesses and trade associations, consumer representatives, State and local enforcement officials, and others—to come up with a reasonable compromise.

At the time it seemed that it would not be too difficult to get all sides to agree to an approach to reforming the statute. A year later, after hundreds of meetings, I see the task was more difficult than I assumed.

Nevertheless, I do believe that S. 1523 represents the best hope for a fair and responsible reform of the RICO statute, and it is only fair to say to those who are strong advocates on both sides of the question that if there is no compromise, if there is no piece of legislation on which there is general agreement, there will be no legislation.

S. 1523 eliminates treble damages in the category of cases where the worst abuse has occurred—businesses suing other businesses. On the other hand, it makes no changes in criminal provisions which have been used to prosecute organized crime and other sophisticated criminal enterprises. And it preserves strong civil remedies for government entities and consumers.

I am pleased that a broad cross-section of the business community, organized labor, the ACLU, and others have endorsed S. 1523. I understand some continue to oppose the bill on the grounds that it goes too far in revising the statute.

Frankly, I am prepared to admit that S. 1523 is not a perfect bill, but I think it is a good bill and that it is the best bill which has a chance of passing. And I am convinced that responsible RICO reform will not occur if there is not give-and-take on all sides.

Some business organizations, particularly the accounting profession, have decided to oppose this bill because of one provision. That provision allows a small investor to seek punitive damages in cases of egregious criminal fraud. I consider this provision absolutely essential to adequate protection of the most vulnerable members of the public from unfair exploitation in the sale of securities, and there are many who feel that it goes too far in the wrong direction.

Under the small investor provision, a person who owns less than approximately \$8,000 in securities or who earns less than approximately \$25,000 in household income could ask the court to award up to twice his or her actual damages in cases of egregious criminal fraud involving the sale of securities.

Since punitive damages are not available under the federal securities laws for ordinary civil fraud, it is essential to preserve this remedy to protect the most vulnerable persons who buy stock in this country.

This simple and limited provision does not impose an unfair burden on those who might be defendants in a RICO case. It is a matter of simple fairness and justice to those small shareholders most likely to be exploited in the sale of securities.

I reject totally the argument that some have made that we should deprive these individuals of this remedy in the most egregious cases of criminal fraud simply because potential defendants do not want to bear the inconvenience of defending themselves.

In fact, this provision is so essential to a fair reform of RICO that I will oppose strongly any RICO reform bill that does not include it. And I say that, in my own view, it probably does not go far enough. I think that \$8,000 is a very modest figure.

I look forward to hearing from our impressive list of witnesses today, and I hope that this is the first step in an expeditious and fair reform of RICO.

Senator DeConcini, do you have a statement?

Senator DeCONCINI. I have no statement at this time. Thank you, Mr. Chairman.

Senator METZENBAUM. Thank you.

I have a statement, and also, we have prepared statements from Senators Biden, Thurmond, and Grassley which we will include in the record at this point.

[Statements follow:]

U.S. Senator Howard M.

METZENBAUM

of Ohio

Committees:
Judiciary
Labor and Human Resources
Energy and Natural Resources
Select Committee on Intelligence

Chairmanships:
Subcommittee on Antitrust
Subcommittee on Labor
Subcommittee on Energy
Regulation and Conservation

OPENING STATEMENT BY SENATOR METZENBAUM

HEARING ON S.1523 TO REFORM RICO

OCTOBER 29, 1987

RICO, THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT, HAS HAD A CHECKERED HISTORY SINCE IT WAS PASSED IN 1970. IT HAS SERVED AS A STRONG AND EFFECTIVE TOOL AGAINST ORGANIZED CRIME AND CRIMINAL FRAUD. ON THE OTHER HAND, THE LURE OF AUTOMATIC TREBLE DAMAGES AND THE BROAD STANDARDS FOR LIABILITY HAVE MADE RICO AN OVERUSED CLAIM IN TOO MANY CASES OF ROUTINE BUSINESS LITIGATION.

THE DEBATE OVER RICO REFORM HAS RAGED INSIDE AND OUTSIDE CONGRESS FOR THE LAST SEVERAL YEARS. ABOUT A YEAR AGO, I DIRECTED MY STAFF TO MEET WITH INTERESTED PARTIES -- BUSINESSES AND TRADE ASSOCIATIONS, CONSUMER REPRESENTATIVES, STATE AND LOCAL ENFORCEMENT OFFICIALS AND OTHERS -- TO COME UP WITH A REASONABLE COMPROMISE. AT THE TIME, IT SEEMED THAT IT WOULD NOT BE TOO DIFFICULT TO GET ALL SIDES TO AGREE TO AN APPROACH TO REFORMING

THE STATUTE. A YEAR LATER, AFTER HUNDREDS OF HOURS OF MEETINGS, I SEE THE TASK WAS MORE DIFFICULT THAN I ASSUMED!

NEVERTHELESS, I DO BELIEVE S. 1523 REPRESENTS THE BEST HOPE FOR A FAIR AND RESPONSIBLE REFORM OF THE RICO STATUTE. IT ELIMINATES TREBLE DAMAGES IN THE CATEGORY OF CASES WHERE THE MOST ABUSE HAS OCCURRED -- BUSINESSES SUING OTHER BUSINESSES. ON THE OTHER HAND, IT MAKES NO CHANGES IN CRIMINAL RICO PROVISIONS, WHICH HAVE BEEN USED TO PROSECUTE ORGANIZED CRIME AND OTHER SOPHISTICATED CRIMINAL ENTERPRISES. AND, IT PRESERVES STRONG CIVIL REMEDIES FOR GOVERNMENT ENTITIES AND CONSUMERS.

I AM PLEASED THAT A BROAD CROSS-SECTION OF THE BUSINESS COMMUNITY, ORGANIZED LABOR, THE ACLU AND OTHERS HAVE ENDORSED S. 1523. I UNDERSTAND SOME CONTINUE TO OPPOSE THE BILL ON THE GROUNDS THAT IT GOES TOO FAR IN REVISING THE STATUTE. FRANKLY, I DO NOT THINK S. 1523 IS A PERFECT BILL, BUT I THINK IT IS A VERY GOOD BILL AND THAT IT IS THE BEST BILL WHICH HAS A CHANCE OF PASSING. AND, I AM CONVINCED THAT RESPONSIBLE RICO REFORM WILL NOT OCCUR IF THERE IS NOT GIVE AND TAKE ON ALL SIDES.

SOME BUSINESS ORGANIZATIONS, PARTICULARLY THE ACCOUNTING PROFESSION, HAVE DECIDED TO OPPOSE THIS BILL BECAUSE OF ONE PROVISION. THAT PROVISION ALLOWS A SMALL INVESTOR TO SEEK PUNITIVE DAMAGES IN CASES OF EGREGIOUS CRIMINAL FRAUD. I CONSIDER THIS PROVISION ABSOLUTELY ESSENTIAL TO ADEQUATE PROTECTION OF THE MOST

VULNERABLE MEMBERS OF THE PUBLIC FROM UNFAIR EXPLOITATION IN THE SALE OF SECURITIES.

UNDER THE SMALL INVESTOR PROVISION, A PERSON WHO OWNS LESS THAN APPROXIMATELY \$8,000 IN SECURITIES OR WHO EARNS LESS THAN APPROXIMATELY \$25,000 IN HOUSEHOLD INCOME COULD ASK THE COURT TO AWARD UP TO TWICE HIS OR HER ACTUAL DAMAGES IN CASES OF EGREGIOUS CRIMINAL FRAUD INVOLVING THE SALE OF SECURITIES. SINCE PUNITIVE DAMAGES ARE NOT AVAILABLE UNDER THE FEDERAL SECURITIES LAWS FOR ORDINARY CIVIL FRAUD, IT IS ESSENTIAL TO PRESERVE THIS REMEDY TO PROTECT THE MOST VULNERABLE PERSONS WHO BUY STOCK IN THIS COUNTRY.

THIS SIMPLE AND LIMITED PROVISION DOES NOT IMPOSE AN UNFAIR BURDEN ON THOSE WHO MIGHT BE DEFENDANTS IN A RICO CASE. IT IS A MATTER OF SIMPLE FAIRNESS AND JUSTICE TO THOSE SMALL SHAREHOLDERS MOST LIKELY TO BE EXPLOITED IN THE SALE OF SECURITIES. I REJECT TOTALLY THE ARGUMENT SOME HAVE MADE THAT WE SHOULD DEPRIVE THESE INDIVIDUALS OF THIS REMEDY IN THE MOST EGREGIOUS CASES OF CRIMINAL FRAUD SIMPLY BECAUSE POTENTIAL DEFENDANTS DO NOT WANT TO BEAR THE INCONVENIENCE OF DEFENDING THEMSELVES. IN FACT, THIS PROVISION IS SO ESSENTIAL TO A FAIR REFORM OF RICO THAT I WILL OPPOSE STRONGLY ANY RICO REFORM BILL THAT DOES NOT INCLUDE IT.

I LOOK FORWARD TO HEARING FROM OUR IMPRESSIVE LIST OF WITNESSES TODAY, AND I HOPE THAT THIS IS THE FIRST STEP IN AN EXPEDITIOUS AND FAIR REFORM OF RICO.

STATEMENT OF SENATOR JOSEPH R. BIDEN, JR.
ON PROPOSED CIVIL RICO REFORM LEGISLATION
OCTOBER 29, 1987

I welcome these hearings as an opportunity to air all points of view on this important and controversial legislation. Since the Supreme Court's decision in the case of Sedima, S.P.R.L. v. Imrex Co., Congress has wrestled with proposals to limit the application of the civil RICO statute to cases and controversies that fall within the original intent and meaning of the law, without jeopardizing the role that this statute can, and has, played in fighting organized and white collar crime. Study after study has demonstrated that some correction is needed, but any reform should not be at the expense of significant law enforcement goals.

In prior years, the debate on civil RICO reform began with discussion of whether a prior criminal conviction should be required to invoke this statute. I strongly believed that such a requirement would undermine the usefulness of civil RICO in fighting organized and white collar crime and fraud, and so I opposed any such limitation.

This year, we begin the debate with a bill that has garnered widespread support from many of the business groups most affected by this legislation. However, it leaves civil RICO intact as a powerful crime-fighting tool. The suggested changes in the bill, which have been offered by the Justice Department, the American Bar Association and various affected groups, are constructive and will be seriously taken into account as the committee works to develop the best possible legislation.

The controversy that surrounds this legislation is indicative of the important role it plays in our scheme of criminal and civil justice. We should proceed cautiously, but we should proceed, in reforming this critical statute.

STATEMENT BY SENATOR STROM THURMOND (R-S.C.) BEFORE THE SENATE JUDICIARY COMMITTEE, REFERENCE S. 1523, A BILL TO AMEND THE CIVIL REMEDY PROVISIONS OF THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO), 226 DIRKSEN SENATE OFFICE BUILDING. THURSDAY, OCTOBER 29, 1987, 2:00 P.M.

MR. CHAIRMAN:

The subject of this hearing today is an important one that deserves the attention of this Committee. The civil remedy provisions of the Racketeering Influenced and Corrupt Organizations Act have been abused and are in need of reform.

The original purpose of the civil remedy provisions of the Racketeering Influenced and Corrupt Organizations Act (RICO) was to provide private parties with a mechanism against the infiltration of legitimate businesses by corrupt forces. Organized crime was a prime target of this legislation.

The problem has arisen by virtue of innovative private plaintiffs who have brought actions against legitimate businesses, not those influenced or infiltrated by organized crime. These legitimate businesses are being abused by private actions that turn ordinary commercial disputes, securities litigation, banking transactions, insurance claims, and landlord-tenant disputes into RICO actions. Legitimate businesses have no choice but to settle out of court to avoid public disclosure of unfounded racketeering allegations.

Much thought, scholarly attention, debate, and legislation has been focused on the issue of civil RICO reform. Although there may be general agreement that this remedy has been abused, there has been little agreement on how best to reform this federal

statute. Our responsibility is to determine the most appropriate way to eliminate the abuse of the civil damage remedy while maintaining this remedy in those instances where persons have been victimized by wrongdoing.

I welcome the witnesses today because your views will certainly be critical to our efforts to find a solution to solve the RICO problem. I am particularly interested in the securities issues, the need for punitive damages in some cases, the impact this legislation will have on the federal caseload, the retroactive application of the bill, and the impact this bill will have on those affected by its provisions. The testimony received today will educate us all on these important issues, and I look forward to it.

STATEMENT OF SEN. CHARLES E. GRASSLEY
ON THE RACKETEER INFLUENCED AND
CORRUPT ORGANIZATIONS (RICO) REFORM ACT OF 1987
S. 1523

SENATE JUDICIARY COMMITTEE
OCTOBER 29, 1987

MR. CHAIRMAN, I WANT TO THANK YOU FOR HOLDING THIS HEARING TODAY. I HAVE RECEIVED MANY LETTERS FROM CONCERNED IOWANS REGARDING WHAT THEY THINK WILL BE SUBSTANTIAL NEGATIVE AFFECTS UPON THE SMALL BUSINESSES OF MY STATE SHOULD S. 1523 BE ENACTED INTO LAW AS IT IS PRESENTLY DRAFTED.

I AM GRATEFUL THAT THE COMMITTEE WILL HAVE AN OPPORTUNITY TO DETERMINE WHAT IS THE BEST WAY TO ELIMINATE ANY POTENTIAL ABUSES PRESENTLY OPERATING WITHIN THE CIVIL RICO SECTIONS OF FEDERAL LAW, AND YET RETAIN ITS STRENGTH AS A WEAPON IN THE FIGHT AGAINST WHITE-COLLAR CRIME AND FRAUD.

AS WE ALL ARE AWARE, THE RACKETEERING INFLUENCED AND CORRUPT ORGANIZATIONS (RICO) ACT WAS PASSED BY CONGRESS IN 1970. THE LAW WAS DESIGNED WITH TWO COMPONENTS: ENHANCED CRIMINAL SANCTIONS AND NEW CIVIL REMEDIES. THEY WERE ENACTED TO ATTACK THE CRIMINAL ACTIVITY OF CERTAIN BUSINESS ENTERPRISES.

THE NEW CIVIL REMEDIES WERE SUPPOSED TO ACT AS SUPPLEMENTS TO THE FEDERAL CRIMINAL PROSECUTION FUNCTION. BY INCLUDING TREBLE DAMAGES, COUNSEL FEES, AND PROCEDURAL BENEFITS, THE NEW LAW WAS INTENDED TO ENCOURAGE REMEDIAL CIVIL LITIGATION BY CRIME VICTIMS.

I BELIEVE THAT WE CAN ALL AGREE THAT THIS IS A LAUDABLE GOAL. HOWEVER, AS WE ALL KNOW, OTHER LITIGANTS AND THEIR ATTORNEYS, SEEKING ANY ADVANTAGE AFFORDED THEM BY THE FEDERAL STATUTES, HAVE FILED LAWSUITS UNDER THE CIVIL RICO SECTIONS OF THE CODE.

IN FACT, THESE SECTIONS HAVE BEEN USED IN MANY TYPES OF CIVIL CONTROVERSIES THAT WERE NOT CONTEMPLATED BY CONGRESS WHEN THE SECTIONS WERE PASSED. AND COURT DECISIONS HAVE NOT APPARENTLY DISCOURAGED THE USE OF THE CIVIL RICO SECTIONS IN THESE INSTANCES. INSTEAD, THEY HAVE DEFERRED TO THE CONGRESS TO DECIDE IF ANY FURTHER CHANGES SHOULD BE MADE IN THE CIVIL RICO SECTIONS SPECIFICALLY.

CRITICS OF SUITS FILED UNDER THE CURRENT RICO SECTIONS CONTEND THAT THEY ARE NOTHING MORE THAN FRIVOLOUS; THAT THEY ARE FILED IN ORDER TO RECOVER DAMAGES AND ATTORNEYS' FEES THAT MAY NOT BE AVAILABLE UNDER ANY OTHER FEDERAL CIVIL STATUTE.

THE CRITICS ALSO HAVE SUGGESTED THAT THE USE OF THE RICO SECTIONS IN FEDERAL CIVIL LITIGATION IS A WAY TO GET AROUND AVAILABLE LONG-STANDING STATE LAW REMEDIES THAT THEY MAINTAIN ARE BETTER SUITED TO ASSIST PARTIES TO RECOVER DAMAGES.

MANY IN THE FEDERAL JUDICIARY BELIEVE THAT THE INCREASING NUMBER OF CASES FILED UNDER THE CIVIL RICO SECTIONS UNNECESSARILY ADDS TO THE BURDEN OF THE FEDERAL COURTS BY, IN ESSENCE, INJECTING FEDERAL JURISDICTION OVER DISPUTES THAT SHOULD BE THE PROVENCE OF COMMON-LAW FRAUD.

ALSO, MANY DEFENDANTS TO THESE RICO CASES ARE FACED WITH VERY HIGH DAMAGE DEMANDS THAT THEY MAY SETTLE OUT-OF-COURT TO AVOID THE EXPENSE OF LITIGATION. HOWEVER, THESE SETTLEMENT COSTS ARE THEN PASSED ON TO THE CONSUMER.

FINALLY, IT APPEARS THAT THE RICO SECTIONS SEEM TO HAVE BEEN USED AGAINST EVERY CLASS OF DEFENDANT IMAGINABLE EXCEPT CONGRESS' MAIN TARGET: **ORGANIZED CRIME.**

PROONENTS OF A CIVIL RICO REMEDY HAVE COUNTERED THAT SUITS UNDER THESE SECTIONS ARE NOT FRIVOLOUS BECAUSE PROCEDURAL SAFEGUARDS EXIST TO DISPOSE OF UNFOUNDED CLAIMS BEFORE THE EXPENDITURE OF SIGNIFICANT TIME AND EXPENSE OCCURS.

THESE PROPONENTS OF CIVIL RICO ALSO EXPLAIN THAT PROSECUTORIAL RESOURCES TO COMBAT FRAUD ARE PRESENTLY INADEQUATE. THEREFORE, VICTIMS OF SUCH ENTERPRISES AS MAIL, WIRE, AND SECURITIES FRAUD, ARE ENTITLED TO RECOVER FOR THEIR LOSSES THROUGH THIS SUPPLEMENT TO THE FEDERAL CRIMINAL ENFORCEMENT STATUTES.

IN ADDITION, PROPONENTS OF CIVIL RICO CONTEND THAT THESE SECTIONS DO NOT ENCROACH UPON FEDERALISM OR EXISTING REGULATIONS NOR DO THEY PRE-EMPT STATE ACTIONS. THUS, PROPONENTS EXPLAIN THAT FRAUD, BY TRANSCENDING STATE LINES EVERY DAY, IS SO RAMPANT IN AMERICA THAT THE COMMERCE CLAUSE DOES NOT HAVE TO BE STRETCHED TO WARRANT FEDERAL ACTION. THEY ARGUE THAT IF THERE IS ROOM IN THE LAW FOR A NATIONAL TORT LAW PRODUCTS LIABILITY STANDARD (A DOMAIN TRADITIONALLY LEFT TO THE STATES), THEN THERE IS ALSO ROOM FOR A NATIONAL STANDARD IN THE AREA OF FRAUD REGULATION.

FINALLY, THE PROPONENTS OF HAVING SOME KIND OF CIVIL RICO REMEDY MAINTAIN THAT THERE IS A COMPELLING NEED FOR A REMEDY CAPABLE OF DETERRING CRIME AND PROPERLY COMPENSATING VICTIMS. THE INCLUSION OF ATTORNEYS' FEES IS NECESSARY BECAUSE FEW VICTIMS OF CRIME HAVE THE RESOURCES REQUIRED TO AFFORD WHAT CAN BE COMPLEX CIVIL LITIGATION.

CONSEQUENTLY, ANY PROPOSED CHANGES TO THE PRESENT LAW SHOULD BE CONSISTENT WITH THE ORIGINAL INTENT OF CONGRESS, WHICH WAS TO PROVIDE A SUPPLEMENTAL CIVIL REMEDY FOR PLAINTIFFS WHO HAVE BEEN DAMAGED.

THESE CHANGES WOULD ALSO BE CONSISTENT WITH THE LAW'S OTHER PURPOSE: TO FIGHT CRIME BY COMPLIMENTING THE FEDERAL GOVERNMENT'S OTHER CRIMINAL LAW ENFORCEMENT TOOLS.

CHANGES IN THE OPERATION OF THE PRESENT CIVIL RICO SECTIONS HAVE BEEN PROPOSED AND CONSIDERED IN ORDER TO PROVIDE A REMEDY THAT WOULD DISCOURAGE FRIVOLOUS LAWSUITS AND THAT WOULD COMPLIMENT EXISTING LAW, RATHER THAN CONFLICT WITH IT. MANY OF THESE WERE GIVEN SERIOUS CONSIDERATION, BY BOTH THE HOUSE AND THE SENATE, DURING THE 99TH CONGRESS.

THE MEASURE WE ARE LOOKING AT TODAY, S. 1523, IS THE FIRST OPPORTUNITY WE HAVE HAD DURING THE 100TH CONGRESS TO STUDY PROPOSED CHANGES IN THE OPERATION OF THE RICO SECTIONS.

WE HAVE A RESPONSIBILITY TO MAKE REMEDIES AVAILABLE TO THOSE WHO HAVE SUFFERED INJURY OR DAMAGES. BUT, WE MUST NOT CREATE A WHOLE CLASS OF UNINTENDED VICTIMS BY THE PASSAGE OF SUCH REMEDIAL STATUTES.

IF WE HAVE DONE SO IN THE INSTANCE OF THESE CIVIL RICO SECTIONS--AND THIS HEARING IS TO HELP US DETERMINE IF WE HAVE DONE SO--THEN WE MUST MAKE EVERY EFFORT TO PUT SOME ORDER BACK INTO THE PROCESS, WITHOUT NECESSARILY THROWING OUT THE WHOLE ACT.

IN OUR EFFORT TO PUT ORDER BACK INTO THE PROCESS, HOWEVER, WE SHOULD NOT REPLACE ONE CLASS OF UNINTENDED VICTIMS WITH ANOTHER.

I WILL BE VERY INTERESTED TO HEAR THE RESPONSES OF THE WITNESSES TO THE COMMITTEE'S INQUIRY. THANK YOU, AGAIN, MR. CHAIRMAN.

Senator METZENBAUM. I want to say to all of our witnesses today that I am going to ask you to be extremely brief. I want to share with you that I am playing with a heavy head cold and I thought of calling off the hearing. So many of you had come in from out of the city and from around parts of the country that I decided not to do it, but that does not mean I cannot ask you to make your points briefly.

So we are very happy to have the very distinguished John Conyers, of Michigan, who is chairman of the Subcommittee on Criminal Justice of the House of Representatives.

**STATEMENT OF HON. JOHN CONYERS, JR., A REPRESENTATIVE
IN CONGRESS FROM THE STATE OF MICHIGAN**

Mr. CONYERS. Thank you, Chairman Metzenbaum, Senator DeConcini. What a pleasure to appear before my friends in this Committee to first of all identify that we have worked together on so many criminal justice matters and judiciary matters that I am very pleased for this opportunity to just share a few points with you and join in the discussion on this side of the Capitol on a subject that I have been turning over and over in a few hearings.

I have not met a hundred times with anybody as you have, but I have met with more than a few people and organizations trying to, I think, effect the same thing that you are interested in.

What I wanted to do is just take a few minutes to identify some concerns that I have, and also extend both of you an opportunity to join us on the House side on hearings on one of my proposals on civil RICO that I would like to have you come on over and talk with me about, too.

As a matter of fact, I have been hoping that some way we could begin in the Congress to entertain joint hearings or serial hearings in some depth that covers all of the subject matter that civil RICO has jurisdiction over. It is an incredible list.

In view of the fact that we had a real dislocation on October 19 on Wall Street—and there are a lot of differing explanations for the stock market decline, but one thing is sure, that investor confidence is critical to market stability, and it has been shaken.

And one of the problems that is connected with that disruption in confidence, it seems to me, is the fact that there has been so much corruption, or the perception of corruption, and fraud, insider trading, churning stock, and the dozens of other techniques that are just beginning to come to light. There is more on the way, we all know.

It is against that background that it seems to me we have an even deeper responsibility to move with care on this, and that is why I am hoping that we will have some in-depth hearings and then do what we have to do, rather than close up with a 1-day hearing and then start writing the law.

I am very concerned about the fact of the reason that we created civil RICO. It was to give a private attorney general function to the public in an area that it did not exist. That is what antitrust law created and that is why we got it there.

It has been working reasonably well, but the problem of fraud that civil RICO was intended to address, and I am saying nothing

in my remarks that have anything to do with criminal RICO, is that the problem has gotten worse since 1970 and is continuing to get worse—securities fraud, nearly \$50 billion annually; insurance fraud, \$14 billion; bank fraud accounting for up to half of all of the financial institutional failures, according to my research.

And so the whole idea of reforming RICO turns to me on which way are we going to reform it. Are we going to reform it to strengthen or are we merely going to accede to the cries of a few people who are doomed to be affected by it?

You know, I am impressed by the fact that when people combine for a bad purpose, then the good people have got to associate or else all of the good people are going to fail one by one in an unpitied sacrifice in a contemptible struggle, and part of that was said by me and part of it was said by Edmund Burke in 1770, just for the record. [Laughter.]

Senator METZENBAUM. It is nice of you to give that attribution to him.

Mr. CONYERS. Now, the problem that we are facing is that we are hearing from—my colleagues in the Senate, we are hearing from all the wrong people. The injured parties do not have any associations, do not have lobbyists, do not have people registered on the Hill, are not swarming all over you.

They are not around here to report what has been happening and the good things that have come out of civil RICO. So all I want to point out to you is that we have now evidenced that RICO is not flooding the courts anymore as it was a year-and-a-half ago.

The Accounting Office has told us that that has turned around. We have federal judges telling us that. The docket of RICO cases is less than 1 percent of the Federal docket. No longer can RICO be brought into a Federal court when two phone calls or two letters are brought into play.

We now require a pattern with multiple objectives of criminality. You have to have criminal intent. These are not garden-variety kinds of contractual disputes. Since *Sedima*, *McNulty*, *McMahon*, and *Winnans*, all Supreme Court cases on the record coming down, we all know we have been whittling down and constraining the uses, and some of them were improper uses, of civil RICO.

But businesses have no inherent right to be exempted from the codes of criminal and racketeering conduct, and so all I am here for is to point out that creating more burdens and fewer remedies is just not a way that I think those of you who have fought so hard for consumers, for senior citizens, for people who—the little investor—this is just not the way we want to go.

I do agree that labor disputes should not be a part of civil RICO. We have got Taft-Hartley and Landrum-Griffin. I do agree that marital disputes and landlord-tenant lawsuits and frivolous kinds of cases should not be allowed. But we have found out now through the judges that there are remedies already in the rules.

All right, I will wind up.

We have found out now that there are ways to punish these cases, but for anybody who is a lawyer to come before any committee and talk about how easy it is to bring a RICO case, I think that is doing us a serious disservice.

Those cases were tough to bring. It was a long time before anybody even started using civil RICO, and they are now getting tougher to bring since the courts have been changing things.

And so I join you here looking for a common basis, Mr. Chairman, for reform and hoping that somehow or other our committees can work together in this important area.

Senator METZENBAUM. Thank you, Congressman Conyers. We have worked together on many matters and I am sure we will continue to work together on this. Thank you for an excellent statement.

Senator DeConcini, do you have any questions?

Senator DeCONCINI. Only a comment.

Congressman, you say that the people out here, the consumer or what have you, have no association or lobby. What do you feel about the Attorney Generals Association and the particular attorneys general who are elected by the people? Do they not in some manner convey to us some credibility for enforcement?

Mr. CONYERS. Absolutely, they sure do, and they are good friends of mine, but their interest in this matter is limited to the way that they proceed as State officers themselves.

They are not in any position—as a matter of fact, they are going to be using *parens patriae* representing people, but we are talking about all the people that fall through the cracks. The little investor cannot go to the Attorney Generals Association. The senior citizen sometimes can and sometimes cannot.

But you are right; to that extent, they are representing all of their citizens.

Senator DeCONCINI. Thank you.

Senator METZENBAUM. Thank you very much, Congressman Conyers.

Mr. CONYERS. Thank you very much.

Senator METZENBAUM. Thank you.

[Statement follows:]

PREPARED TESTIMONY

HONORABLE JOHN CONYERS, JR.
Chairman, House Judiciary Subcommittee on Criminal Justice

BEFORE THE
SENATE COMMITTEE ON THE JUDICIARY

ON
CIVIL RICO

Thursday, October 28, 1987

Mr. Chairman, members of the committee, thank you for providing me the opportunity to testify today on an issue of considerable importance to me, to law enforcement and victims of crime: civil RICO.

The hearings now could not be more timely given recent events on Wall Street. For all the differing explanations of the stock market decline boil down to one essential point: that investor confidence is critical to market stability.

And while the budget and trade deficits appear clearly the major factors, the perception of corruption on Wall Street during the past year cannot be ignored as having contributed to an erosion in investor confidence. Already we are seeing in just these past two weeks small investors being blocked out of the market. Scores of lawsuits are expected to be filed. The system certainly now needs reinforcement with law that will impose and maintain integrity.

That is an appropriate starting point for discussing civil RICO. For in my judgement the basic issue is that white collar crime and fraud are of scandalous proportions, costing over \$200 billion annually, and current law and law enforcement efforts-- both private and public -- are incommensurate to the nature and scope of the problem. Very little money defrauded is ever returned to victims and in my view civil RICO and other anti-

fraud laws that protect citizens need strengthening, not weakening.

Civil RICO was enacted in 1970 as part of a comprehensive effort to fight organized and white collar crime. Its essential purpose was to help underresourced public prosecutors by giving citizens a "private attorney general function" -- the right to sue crooks and cheats that defraud them for treble damages.

Today fraud and corruption have grown to proportions never imagined in 1970. Securities fraud is estimated to cost up to \$50 billion annually, bank fraud to account for up to half of all the bank failures, and insurance fraud is estimated to cost at least \$14 billion annually. Never before has the daily news been so dominated by reports of insider trading and corruption scandals.

Yet today those that oppose civil RICO -- largely special business interests -- make an extraordinary argument that the danger lies in the law itself, that despite the fact that less than one percent of monies defrauded the public are ever recovered, civil RICO is too tough a law, and too far reaching. The arguments are outdated and unconvincing and include the following:

1. Civil RICO litigation is flooding the federal courts: Data collected by the Administrative Office of the Courts show clearly

that civil RICO is not flooding the courts, that out of a 23,000 civil filings monthly only 90 -- approximately .0003% of the total docket -- are civil RICO cases, 60% of which have an independent basis for federal jurisdiction. A respected federal judge in California, Judge Pamela Rymer, with extensive experience in RICO litigation observes that the RICO filings have "calmed down" and actually "present no greater problem than antitrust or complicated securities cases."

2. Civil RICO is used frivolously in ordinary commercial disputes". Since the Supreme Court's decision on the intended scope of RICO in Sedima in July of 1985 -- and at the invitation of the Court to tighten the standards for RICO litigation -- the Circuit Courts of Appeal have made clear that RICO only applies to systematic "patterns" of serious criminal conduct with multiple objectives. While RICO reformers point to trivial instances in which RICO cases have been attempted (domestic disputes, church members, F.B.I. sting operations, etc.) those cases are nearly always dismissed and few if any are today being brought.

The more typical and important application of RICO in commercial disputes include the use by IBM Corporation for theft of software by Hitachi Ltd., a suit settled for upward of \$200 million. The trustee of the Home State Savings Bank also used RICO to sue auditors of E.S.M. Government Securities, Inc. for the injuries

that Ohio bank depositors suffered when E.S.M.'s insolvency was fraudulently hidden from investors in a bribery-secured favorable audit report, a suit that was settled for \$80 million. Other victims -- including businesses -- that have sued under RICO include Standard Oil of Indiana, Armco Steel, The Banker's Trust and Co. and Allstate Insurance Company. RICO is, in short, neither pro-business nor anti-business. It is pro-victim.

3. RICO was intended to apply only to "racketeers" of the classic Edward G. Robinson mold of "Little Caesar". The Supreme Court in Sedima ruled that RICO does and should apply to "any person" and that legitimate businesses "enjoy neither an inherent incapacity for criminal activity nor immunity from its consequences." A recent survey of 1043 businesses reinforces the important point. It showed that between 1970 and 1980 117 businesses had significant convictions or consent decrees for 98 antitrust violations, 28 cases of kickbacks, bribes or illegal rebates, 21 instances of illegal contributions, 11 cases of fraud, and 5 cases of tax evasion. The \$200 billion annual price tag rivals only drug traffic and the fight against it is being largely lost.

The RICO "reform" effort has now abandoned its original goal of the essential repeal of the law with a prior criminal conviction recognizing the inability to justify such a rollback in the midst of an insider trading scandal and corruption climate. The newest

reform effort I believe is still unjustified given the scope of the fraud problem and it is insufficient. That is why I urge you Mr. Chairman to consider working with me on the House side to redraft civil RICO legislation that would toughen the law where needed and make appropriate reforms where real abuses or unintended uses occur. Let me comment first on what I consider the inadequacy of the current reform effort as embodied in S. 1523.

The bill first fails to put new protections where needed. Bank fraud for instance is estimated account for up to half of all bank failures for instance. There are new expectations today that the withdrawal of capital and collateral will precipitate new bank failures in institutions already vulnerable because of fraud.

The bill does nothing about toxic waste offenses. The National Association of Attorney's General support the concept of making a series of toxic waste offenses predicate acts under RICO. Estimates show that as much as 90% of toxic wastes put annually into 170,000 pits, ponds, lagoons and landfills are disposed improperly. The contamination of drinking water of entire communities is of scandalous proportions.

The bill also does nothing about terrorism, including domestic terrorism. Civil Rights organizations and the work of the

Judiciary Subcommittee that I chair have shown shocking increases in anti-semitic and racist acts of violence and terror. With an international service of process, personal injury in cases when violence results, parens patriae RICO could be appropriately used for terrorism. Legislation that I have introduced on the House side includes bank fraud, toxic waste offenses, terrorism and other acts as predicate offenses under RICO.

My second category of concerns center around the weakening provisions of the bill. If the bill is too broadly used, (which I no longer believe it is) then the pattern of predicate acts should be amended to constrain its proper use. But it does not follow that remedies should be changed for that cripples the effectiveness of RICO as an important deterrent and as a victims rights measure.

S. 1523 first deprives businesses of the opportunity to sue for treble damages thereby eliminating one of civil RICO's most important aspects: deterrence. Actual damages in business suits are also insufficient to recover real losses such as lost investment opportunities. It also creates new burdens of proof for private citizens -- seniors cheated out of home improvement funds for instance -- to recover punitive damages.

The bill also has basically unfair provisions for retroactivity: changing the rules of the game for those who are in the middle of

playing it. I believe conceptually that retroactivity is unfair and bad policy.

One would have thought that the level of outrage following the successive revelations of multimillion dollar insider trading scandals would prompt tougher laws, or at least discourage attempts to weaken existing ones. Not so.

The special favors for the securities industry is also unsound and unwarranted. There is no indication that current securities law is adequate to deal with the scope of the \$50 billion annual securities fraud problem and every indication that civil RICO is a deterrent: that's why Boesky plead guilty not to securities fraud or a RICO predicate offense but to a non-RICO predicate offense. And with the recent Supreme Court decision in McNulty in which the Court ruled that arbitration could be compelled, and with the expected ruling on "misappropriation" in Winnans, civil RICO especially under the reform bill will have increasingly few uses in the securities field. There should be no exemption.

Provisions that bar treble damages unless the defendant has a prior criminal conviction of a RICO predicate act I believe are unwise: that gives prosecutors too great and too unfair a bargaining chip.

Neither other federal fraud laws which intervene in limited

instances and provide generally for actual damages, nor current state law is adequate to deal the character of fraud in our modern society. That's why key elements of the law enforcement community -- the National Association of Attorney's General, the head of New York's Organized Crime Task Force -- have called not for weakening the law but for strengthening it. They know from experience that public prosecutors do not have the resources to deal with the scope of the problem.

RECOMMENDATIONS

1. Civil RICO in my judgement should never be used in certain instances: labor-management disputes, landlord or marital disputes. Any amendments to the statute should reflect that.
2. If there are today instances that we can identify RICO's inappropriate use -- for two phone calls or two pieces of mail; to chill First Amendment rights of an individual or organization -- then we should deal with those by clarifying the pattern of predicate acts and requiring specificity in pleadings. But there is no compelling logic to change the remedies available and their important deterrent effects, there is no need to roll back the rights and remedies of individuals and small businesses.
3. Civil RICO and its current remedies should be maintained given

the nature and scope of the fraud problem as we can currently identify it. There is further ample rationale for making as predicate acts invidious types of crime: new kinds of complex fraud, hate violence, toxic waste offenses.

4. I also urge that this committee undertake together with or separate from the House Judiciary Subcommittee which I chair comprehensive and systematic hearings on the nature of fraud and its scope, the ability of public and private law enforcement efforts in dealing with it, and then address the appropriate changes in fraud statutes in that context. I urge against revisions in anti-fraud law studied outside the context of the problem itself.

The RICO "reform" movement of today calls to mind similar efforts in the 1930's directed at the Securities Act of 1933, which were described by Justice, then professor, Frankfurter:

The leading financial law firms who have been systematically carrying on a campaign against this Act have been seeking--now that they and their financial clients have come out of their storm cellar of fear--not to improve but to chloroform the Act. They evidently assume that the public is unaware of the sources of the issues that represent the boldest abuses of fiduciary responsibility

That is true today and we need more protections, not less.

Senator METZENBAUM. Our next panel is William Weld, Assistant Attorney General, Department of Justice, Criminal Division; Cameron Holmes, Assistant Chief Counsel, Special Investigations Division, Office of the Attorney General, Arizona, on behalf of the National Association of Attorneys General; and Philip A. Feigin, Assistant Commissioner, Colorado Division of Securities, on behalf of North American Securities Administrators Association, Denver, CO.

Gentlemen, as the Chair indicated when we started, I am going to limit the witnesses to 5 minutes. I did not think I should limit Congressman Conyers as a matter of comity, but I would appreciate it if you would be good enough to do that, Mr. Weld and each of the others.

STATEMENT OF A PANEL CONSISTING OF WILLIAM WELD, ASSISTANT ATTORNEY GENERAL, CRIMINAL DIVISION, U.S. DEPARTMENT OF JUSTICE, WASHINGTON, DC; CAMERON HOLMES, ASSISTANT CHIEF COUNSEL, SPECIAL INVESTIGATIONS DIVISION, OFFICE OF ATTORNEY GENERAL, STATE OF ARIZONA, ON BEHALF OF THE NATIONAL ASSOCIATION OF ATTORNEYS GENERAL, PHOENIX, AZ; AND PHILIP A. FEIGIN, ASSISTANT COMMISSIONER, COLORADO DIVISION OF SECURITIES, ON BEHALF OF THE SECURITIES ADMINISTRATORS ASSOCIATION, DENVER, CO

Mr. WELD. Thank you very much, Mr. Chairman. The criminal RICO statute, of course, has been very important to the Department of Justice in its fight against traditional organized crime in this country. I personally believe that the civil RICO statute is potentially of virtually equal significance to advancing the Government's interests.

You are familiar with the civil RICO cases that the federal government has brought against Local 560 in New Jersey, the Local 6A case in Manhattan, the Local 814 case in Brooklyn, all of which resulted in court decrees giving the government relief against LCN organized crime infiltration of labor union locals.

I believe that the civil RICO statute is potentially of use to the federal government well beyond the area of organized crime penetration of labor unions. We plan to use it, for example, in the areas of bank fraud, obscenity, government corruption, false claims against the Government, and in order to secure injunctions against con artists, professional white-collar criminals.

The civil RICO statute is of great potential use to the government because, as the Chair is well aware, the standard of proof is a preponderance of the evidence, as against the beyond a reasonable doubt standard in criminal cases.

A party who refuses to take the stand becomes the subject of an adverse inference as to his or her testimony, which is not the case in criminal matters, because the liberal discovery rules are available in civil cases, and because the relief which the court is permitted to award in civil RICO actions is considerably more flexible and indeed more radical in terms of rooting out penetration of legitimate industry and labor than in the criminal area.

So I am happy to find the Department at least not in opposition to the measure being advanced by the Chair and the measure which is pending before the committee today. I do think that the provision clarifying and making it clear that the Federal Government is a person for purposes of collecting treble damages under section 1964 when the Federal Government is injured in its business or property is of tremendous importance to the Federal Government and is one reason why I am happy to be here today.

With respect to the specific comments that we have on S. 1523, Mr. Chairman, we would urge the committee to preserve the RICO and racketeering label for criminal cases. As I indicated in my prepared remarks, we should not lose sight of the fact that there is such a thing as a racketeer and the defendants in criminal RICO cases very often are racketeers.

We would favor an amendment—and almost all of these, I may say, Mr. Chairman, are basically friendly amendments—we would favor an amendment to clarify the government's burden of proof in civil suits and make it clear that the higher standard of proof would not apply to governmental civil actions.

We see no need to subject governmental civil RICO suits to the proposed shortening of the statute of limitations, and we would suggest that that statute be either left as is or pegged at 6 years.

We would suggest the exclusion of governmental civil actions from the affirmative defense and attorneys fee provision of the bill. The attorneys fee provisions could conflict with the standards now applicable to the Government under the Equal Access to Justice Act, and the affirmative defense provision could engender confusion at trial. Reliance on a State regulatory requirement might not be a defense in any event in an action brought by the Federal Government.

As to the small investor provision, Mr. Chairman, this is the one change that we would suggest which would perhaps not be classified by the Chair as a friendly amendment. Our concern there, among other things, is one of workability.

The Securities and Exchange Commission does not have the staff that the Bureau of Labor Statistics does, and it might be quite burdensome for them to keep the figures on median portfolio income. If you think back to last week and the fluctuations in the market, they might have to keep those statistics on almost a daily basis if the market was going up and down.

There is a consideration of equal protection which does come into play here, giving a remedy only to persons who have a——

Senator METZENBAUM. Would you suggest a different amount or different way of calculating it, or do you object to the——

Mr. WELD. No. I think the objection is in principle, Mr. Chairman. In response to your point that this is a vulnerable class of investors, our response would be simply that there are the securities laws and if people are victimized by a really bad actor, securities fraud is still a predicate under the RICO statute. So if that fellow is convicted under securities fraud RICO, then your investors who are harmed would have their treble damages.

But in conclusion, Mr. Chairman, if the amendments that the Department has proposed are accepted, we would interpose no ob-

jection to the bill; we would file, as it were, a concurring opinion, neither joining in the majority opinion, nor filing a dissent.

Thank you very much.

[Statement follows:]



Department of Justice

STATEMENT

OF

WILLIAM F. WELD
ASSISTANT ATTORNEY GENERAL
CRIMINAL DIVISION

BEFORE

THE

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

CONCERNING

S. 1523 - RICO REFORM LEGISLATION

ON

OCTOBER 29, 1987

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Mr. Chairman and Members of the Committee, it is a pleasure to be here today to discuss with you pending proposals to amend the criminal and civil provisions of the RICO statute.

Under the current criminal code, two of the most powerful, effective statutes are RICO and CCE (the Continuing Criminal Enterprise, or drug kingpin, statute)^{1/}. Since RICO is broader in scope and has impact on private as well as governmental litigation, it has been widely used. Congress has received numerous requests in recent years to cut back or even eliminate civil RICO. The United States Supreme Court, in 1985, implied that Congress might wish to consider some changes in RICO^{2/}. Although some legislative proposals in the past have sought such changes only in the principal civil RICO provision (18 U.S.C. Section 1964), some current recommendations would spill over into the criminal RICO provisions by redefining such terms as "enterprise" and "pattern of racketeering."

Today, I wish to emphasize two points at the outset. First, the Federal Government needs a strong RICO statute, in its criminal and civil forms, if our recent successes against organized

^{1/} 21 U.S.C. §848.

^{2/} The Court noted: "It is true that private civil actions under the statute are being brought almost solely against [legitimate businesses], rather than against the archetypal, intimidating mobster. Yet this defect--if defect it is--is inherent in the statute as written, and its correction must lie with Congress." Sedima, S.P.R.L. v. Imrex Co., 105 S. Ct. 3275, 3287 (1985) (footnote omitted).

crime are to continue. Second, we support the Committee's efforts to identify and correct problems in the civil RICO arena.

I. A STRONG RICO STATUTE

The Department has achieved unprecedented successes against organized crime in recent years. Results against La Cosa Nostra (the LCN) have been particularly satisfying. The government has used RICO to dismantle organized crime families around the country. In the 1980s, we have secured RICO convictions of the heads and principal lieutenants of LCN families in Boston, Buffalo, Kansas City, Cleveland, Los Angeles, New Orleans, Philadelphia, Rochester, and four of the five LCN families in New York City. This list does not include dozens of additional RICO convictions of organized crime members and associates. In most of these cities, several RICO prosecutions have been brought as part of a unified campaign.

A few examples should demonstrate, I believe, how important RICO is to the government and why any legislative cutback in RICO should be confined to private civil RICO suits.

Perhaps the sincerest endorsement of RICO since it was enacted in 1970 came from the lips of the Boston LCN leadership

in 1981. In United States v. Angiulo ^{3/}, the hierarchy of the Boston crime family, including its boss Gennaro Angiulo, his counselor, and several capos, were convicted of RICO in 1986, after an eight-month trial. The case was predicated on court-authorized electronic surveillance in which the defendants were overheard discussing six murders and a wide variety of street crimes and illegal financial investments. Eventually, the defendants received lengthy jail sentences and forfeited real estate worth \$4 million.

At the time of the electronic surveillance of the Angiulo defendants, the landmark Turkette case^{4/} was before the Supreme Court^{5/}. Mr. Angiulo and his associates had the following to say about the RICO statute:

----- (Concerning a newspaper article saying that, under Turkette, RICO only applied to legitimate businesses.) Angiulo: "The law was only written for people like us."

^{3/} Crim. No. 83-235 (D.Mass).

^{4/} United States v. Turkette, 632 F. 2d 896 (1st Cir. 1980), rev'd, 452 U.S. 576 (1981).

^{5/} In Turkette, the Supreme Court held that an organized crime group could constitute a RICO "enterprise." The Turkette case came out of Boston, where the Court of Appeals for the First Circuit had ruled that a RICO enterprise must be a legitimate
(Footnote Continued)

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-----Angiulo: "If you went across the street and lent a guy \$100,000, that is a legitimate business; . . . [but if a debtor failed to] send . . . seventy hundred this month . . . [and the mob came] . . . up there to talk to [him], you are falling under RICO." . . . When the law first came out, the only people who knew anything about it was us!"

Mr. Angiulo speculated what would happen if the First Circuit's view of Turkette were upheld:

-----"We're off the hook. We can do anything we want. They can stick RICO. I wouldn't be in a legitimate business for all the money in the world to begin with."

In another instance, Mr. Angiulo gave a partial listing of RICO predicate crimes, including correct citations of the federal statutes governing gambling and extortion--and then said:

-----"You are just beginning to make the framework of the RICO . . . an enterprise. Remember that word. Enterprise. And it isn't [a] U.S. aircraft carrier either. All it takes is one guy."

(Footnote Continued)
entity. Thus, the outcome of Turkette was of great interest to the Angiulo group, which knew it was a potential RICO target.

Throughout the Angiulo interceptions, which were laced with references to RICO, the defendants expressed fear of the statute's substantive reach and of its penalties, especially forfeiture.

In Manhattan, millions of Americans closely followed the progress of the so-called La Cosa Nostra (LCN) "Commission"^{6/} and "Pizza Connection"^{7/} RICO cases. In the former, the ruling body of New York City's five LCN families, known as the "Commission," was the RICO enterprise. In addition to the usual evidence of murders, extortion, and labor racketeering typical of organized crime, the evidence also revealed that the Commission, through its control of Local 6A of the Concrete and Cement Workers Union, extorted 2% of every concrete contract in Manhattan exceeding a projected cost of \$2 million. In effect, the mob imposed a 2% sales tax on major construction projects in Manhattan.

The principal defendants were convicted and received jail sentences up to 100 years for RICO and related offenses. In the "Pizza Connection" case, after a trial exceeding a full year, 30 international heroin traffickers were convicted of importing tons of heroin into the United States and exporting hundreds of

^{6/}United States v. Salerno, No. 85 Cr. 139 (S.D.N.Y.).

^{7/}United States v. Badalamenti, No. 84 Cr. 236 (S.D.N.Y.).

millions of dollars in laundered profits into foreign bank accounts around the world.

The RICO convictions of mob bosses Carl Civella and Carl DeLuna in Kansas City in 1984 and 1986 marked the climax of a series of prosecutions which involved the skimming of money from several Las Vegas casinos. The prosecutions were based on four thousand hours of electronic surveillance in five judicial districts.

The Kansas City skimming prosecution included evidence that certain LCN defendants used their influence with the Teamsters Central States Pension Fund in Chicago in order to obtain loans exceeding \$80 million for the acquisition and improvement of casinos.

In Brooklyn, 15 defendants, including Bonanno LCN boss Philip Rastelli and the entire leadership of Teamsters Local 814, were convicted in 1986 of a RICO bid-rigging, kickback scheme to monopolize New York City's moving and storage industry, including government moving contracts^{8/}.

At the same time that the Rastelli defendants were unlawfully operating and extorting moving and storage companies,

^{8/} United States v. Rastelli, No. CR-85-354 (E.D.N.Y.).

members of the Lucchese LCN family had moved to take control of commercial trucking traffic at New York's Kennedy Airport. Again using RICO, federal prosecutors in Brooklyn in 1986 convicted Harry Davidoff, a prominent official of Teamsters 851, and several other defendants for systematically extorting kickbacks from domestic and international freight forwarders vulnerable to labor unrest.

Also in Brooklyn, Colombo family capo Michael Franzese in 1986 received a ten-year RICO sentence, forfeited \$4 million to the United States, and was ordered to pay \$10 million in restitution to New York, Florida, and New Jersey tax authorities. Franzese's business activities included automobile dealerships, oil and gasoline distributorships, a movie production company, construction firms, and a union-sponsored employee benefit plan.

As will be evident from the foregoing list, it has been demonstrated in a number of cases that corrupt relationships exist between organized crime and legitimate business. In some instances, this mob influence may not be defeated by criminal prosecutions alone. By the time a mob figure has been sent to jail following indictment, trial, and appeals, his crime family has had sufficient time to replace him, if necessary, in his business or labor union. One response to this problem is civil RICO, aggressive use of which is a top priority of the Department of Justice.

When Deputy Assistant Attorney General John C. Keeney appeared before a House subcommittee in September 1985 on the issue of civil RICO reform, he described the government's civil RICO case against Teamsters Local 560 ^{9/}, which at that time was still on appeal. Since 1986, when the Supreme Court denied the defendants' petition for certiorari, the Local 560 approach has been used to attack labor racketeering on the civil front. As noted earlier, the government successfully used the Local 560 model to remove the Colombo LCN from control of Cement and Concrete Local 6A in Manhattan. In August 1987, we followed up RICO criminal convictions in the Rastelli case^{10/} with civil RICO charges in United States v. Bonanno Family^{11/}. A consent judgment against the labor union defendants was entered on October 9, 1987, only six weeks after the suit was filed. Under the judgment, Teamsters Local 814's entire Executive Board resigned, the previously convicted organized crime defendants were permanently barred from union office, and a trustee was appointed by the court. To secure the removal of an entire mob-influenced executive board with its consent within six weeks of filing suit is a tribute to the strength of RICO and the government's case. The

^{9/}United States v. Local 560, International Brotherhood of Teamsters, 581 F. Supp. 279 (D.N.J. 1984), aff'd, 780 F.2d 267 (3d Cir. 1985), cert. denied, 106 S. Ct. 2247 (1986).

^{10/}United States v. Rastelli, No. Cr-85-354 (E.D.N.Y.).

^{11/}No. CV-87-2974 (E.D.N.Y. filed August 26, 1987).

Justice Department would be loath to see any change in RICO that might make similar cases less likely in the future.

Finally, I note the filing of the Fulton Fish Market civil RICO suit in Manhattan on October 15, 1987^{12/}. This suit alleges that the Genovese LCN family, including 29 named LCN members and associates, controls United Seafood Workers Local 359 and, through that mechanism, controls the importation and distribution of most of the seafood sold in New York City, amounting to one billion pounds annually with a value of several billion dollars. Through alleged bribes, kickbacks, extortions, thefts (called "tapping"), and even illegal gambling, the defendants allegedly seized control of an entire area in New York City, a small area geographically but an important commercial center for fish wholesalers, retailers, dock workers, truckers, shippers, runners, local store owners, and public traffic.

The civil RICO complaint in the Fulton Fish Market case alleges that the mob has controlled the Market for decades. Earlier criminal RICO convictions of key defendants did not entirely break the grip of the Genovese LCN. In 1981, Carmine and Peter Romano were convicted of RICO-labor racketeering

^{12/} United States v. Local 359, United Seafood Workers, Smoked Fish & Cannery Union, United Food and Commercial Workers International Union, AFL-CIO, No. 87 Civ. 7351 (S.D.N.Y. filed October 15, 1987).

offenses relating to Seafood Workers Local 359. The appeals court decision in that case^{13/} noted that the defendants had created a climate of fear and intimidation at the Market. When Carmine and Peter Romano went to jail, however, the Genovese LCN sent in a new team; the climate remained largely unchanged. We think civil RICO actions are part of the answer to such situations.

In addition to the injunctive-type relief sought in the Local 560, Local 6A, and Fulton Fish Market cases, it is our position that the government is a "person" entitled to treble damages within the meaning of § 1964(c) when injured in its business or property. One court has upheld this position. In United States v. Barnette the Department's Civil Division filed a civil RICO suit after the defendants were successfully prosecuted under criminal RICO for defrauding the Department of Defense in connection with the awarding of laundry contracts^{14/}. The government is seeking to recover more than \$47 million in damages from two businessmen and three companies. The District Court has upheld the government's position that it is a "person" under Section 1964(c). We are also requesting injunctive relief in order to divest the individual defendants of their interests in

^{13/}United States v. Romano, 684 F.2d 1057 (2d Cir.), cert. denied, 459 U.S. 1016 (1982).

^{14/}United States v. Barnette, No. 85-754-CIV-J-16 (M.D. Fla. filed May 16, 1985).

certain companies and to bar them from doing further business with the government. This case is still pending.

A second civil RICO suit for treble damages was filed in Brooklyn in 1985. In the case of United States v. Shasho, the government's complaint alleges that more than thirty accountants, insurance adjusters, and businessmen defrauded the Federal Emergency Management Agency of \$1 million by filing fraudulent insurance claims^{15/}. Twenty-three of the defendants have previously been convicted of criminal charges related to the scheme. The suit seeks \$3 million in treble damages.

A third civil RICO case, United States v. Turoff, was filed by the United States Attorney in Brooklyn on behalf of the National Credit Union Administration^{16/}. It charges four defendants with defrauding a federally insured credit union of \$1.2 million. The defendants, who have been convicted of criminal charges, owned a company through which they paid bribes to secure the rights to install electronic meters in New York City taxicabs. The investigation of these bribes eventually unraveled corruption throughout New York City's transportation agencies.

^{15/} United States v. Shasho, No. CV-86-1667 (E.D.N.Y. 1986).

^{16/} United States v. Turoff, No. CV-87-1324 (E.D.N.Y. 1987).

In addition to these three cases, the Federal Deposit Insurance Corporation (FDIC) has brought two civil RICO lawsuits in its capacity as receiver for banks which it has taken over^{17/}. The complaints filed in these cases, which are still pending, seek to recover treble damages from defendants who allegedly engaged in fraudulent activity which caused the banks to become insolvent.

The area of bank fraud is one which the Department is examining very closely with respect to the potential use of civil RICO. According to the FDIC, there were 145 bank failures in 1986 and 1,500 financial institutions are on the watch list. It is estimated that one-half of these failures involve criminal activity by insiders and/or outsiders. Civil RICO cases by the government could play a significant role in deterring further bank fraud by enjoining defendants from further involvement in the banking business and by recouping losses through treble damage suits.

While we are hopeful that the appellate courts will agree with the proposition that the United States is a Section 1964(c) "person," we strongly encourage Congress to amend civil RICO to make the statute explicit on this point. We need the full potential of Sections 1964(a) and 1964(c) to send the message

^{17/}FDIC v. Antonio, No. 85-C-1298 (D. Colo.); FDIC v. Renda, No. 85-2216-C (D. Kansas).

that crime not only doesn't pay, it will cost criminals three times their criminal proceeds.

In addition to our comments below on S. 1523, we would like to make two additional recommendations for strengthening Section 1963, RICO's criminal penalty provision. First, the maximum sentence currently available under Section 1963 is twenty years imprisonment. In many RICO cases that have been successfully prosecuted, this punishment does not fit the crime. For example, in the Angiulo and LCN "Commission" cases, the defendants planned and committed several murders which would be punishable (if prosecutable) by life imprisonment under state law. An appropriate sentence for such crimes may be available in a RICO prosecution only if the defendant is convicted of multiple counts. It would serve the ends of justice, we believe, to adopt the approach of Section 1952B(a)(1) and (2), enacted by Congress in 1984, to deal with violent crimes in aid of racketeering activity. If this were done, a RICO defendant would face life imprisonment for a predicate act of homicide, and thirty years for a predicate act of maiming.

Second, we believe that violations of recently enacted Title 18, United States Code, Section 1029, concerning fraud in connection with credit cards, electronic banking cards, and similar "access devices," should be added to the list of RICO predicates in Section 1961(1)(B). Trafficking in and use of

counterfeit credit cards is a common activity of organized criminal groups.

II. S. 1523

Our comments on S. 1523 are as follows:

1. Preserve the "RICO" Label for Federal Criminal Actions.

First, we firmly believe that the "RICO" label should be retained for federal criminal actions. For the past seventeen years, the RICO statute has become well known to the courts, to the public, and to the legal community. We believe "RICO" accurately reflects the activity to which it applies. No better examples can be found than the LCN "Commmission" and Angiulo cases and the many other RICO cases against professional organized criminals, to which the term "racketeering" easily and justly applies. Mr. Chairman, there is such a thing as a racketeer, and these people are racketeers! To delete RICO's reference to racketeering enterprises (such as La Cosa Nostra) would send the wrong message to law enforcement. It also might undermine the statute's effectiveness by appearing to shift the focus of RICO away from racketeer enterprises to individual crimes. Yet, as noted by the Supreme Court's decision in the Turkette case, RICO is primarily addressed to the racketeer enterprise, its structure, and its existence independent of its activities. The same is true of our civil RICO cases, such as the Local 560, Local 6A, and Bonanno Family cases, where the aim is to restore the integrity of unions and businesses.

Local 6A, and Bonanno Family cases, where the aim is to restore the integrity of unions and businesses.

2. Clarify the Government's Burden of Proof for Civil Suits.

The provision of the bill designated as 18 U.S.C. Section 1964(c) (2) (B) (ii) (II) (cc) establishes a higher standard of proof, clear and convincing evidence, for actions seeking punitive damages on behalf of private litigants or special units of local government and could thus cause confusion over the standard of proof required in civil actions brought by the United States or a state or local government. To avoid any adverse impact upon governmental civil actions, proposed subparagraph (c)(1) (A) of the bill and existing subsection 1964(a) should be revised by adding "upon proof by a preponderance of the evidence" at the appropriate points.

3. Do Not Subject Governmental Civil Suits to the Proposed Statute of Limitations.

We are not aware of any demonstrated need for shortening the period of limitations for governmental civil suits and accordingly suggest that the words "other than an action brought pursuant to subparagraph (c) (1) (A)" be added after the word "subsection" in proposed 18 U.S.C. Section 1964(c) (4) (A); that a new subparagraph (B) be added as follows: "A civil action brought pursuant to subparagraph (c) (1) (A) may not be commenced after the latest of six years from accrual of the cause of action, three years after the conduct causing injury terminates,

or two years after the date of the criminal conviction"; and that proposed subparagraph (B) be redesignated as "(C)".

4. Exclude Governmental Civil Actions From the Affirmative Defense and Attorney's Fee Provisions.

This end could be accomplished by adding the words "other than an action brought pursuant to subparagraph (c)(1)(A)" after the word "subsection" in paragraphs (C)(5) and (C)(7). The first part of this suggested modification reflects our view that the proposed affirmative defense may be meaningless but that it could increase confusion at trial. If government suits are not covered by the provision, we would not object to it. As to attorney's fees, the liability of the Federal Government is controlled by existing law on a basis inconsistent with that proposed in the bill. For example, the Equal Access to Justice Act provides for attorney's fees against the United States "unless the court finds that the position of the United States was substantially justified or that special circumstances make an award unjust."^{18/} We are opposed to a different rule in RICO cases and expect that state and local governments would likely have similar objections.

5. Delete "Small Investor" Provision.

Federal and state securities laws provide remedies for victims of securities offenses, a point reflected in the fact that S. 1523 bars punitive damages if a cause of action is

^{18/} 28 U.S.C. § 2412(d)(1)(A).

available to the plaintiff under such laws. To make the availability of this bar depend upon whether a person has more or less than either the "mean portfolio value" of all investors or the "median household income," runs counter to the principle of equal justice under the law.

6. References to "Subsection".

One technical issue is the use of the term "subsection" in several provisions of S. 1523. For example, the bill's versions of 18 U.S.C. Section 1964(c)(5), (c)(6), (c)(7), and (c)(8) expressly apply to all actions brought under "this subsection," namely, 18 U.S.C. Section 1964(c). Therefore, the bill makes those provisions applicable to actions for treble damages brought by the United States. However, some of these provisions either cannot or should not apply to suits by the United States. For example, 18 U.S.C. Section 1964(c)(6) concerns evidence relating to punitive damages. However, the punitive-damages provision of the bill applies only to suits by persons other than government entities, and not to suits by the United States. Similarly, the provisions relating to affirmative defense and frivolous suits should not be made applicable to suits by the United States. In order to remedy this situation, a preferable approach would be to make these provisions applicable to actions "brought under subsection 1964(c)(2)," rather than "this subsection." Under

that approach, these restrictions would apply only to suits brought by private persons^{19/}.

7. Reservations Regarding Consumer Provision.

Under the bill, a natural person victimized by a pattern of unlawful activity could sue a defendant either (1) for treble damages if the defendant had previously been convicted of the conduct in question; (2) for actual damages in any case; or (3) for punitive damages (twofold the actual damages) if the plaintiff demonstrated that he had been injured in connection with the purchase or lease of a product, service, investment, or property intended for personal or household use or for investment. This relief would be available only if the plaintiff lacked a current remedy under specified securities laws and only if the plaintiff proved by clear and convincing evidence that the defendant acted in conscious and wanton disregard of the consequences of his actions.

We understand the philosophy behind this amendment--to provide greater protections to the consumer. There are problems with this approach, however. Permitting a consumer's cause of action for "wanton" acts by manufacturers, while wholly laudable, is far removed from RICO's original purpose, which was to provide

^{19/} In the alternative, as noted in connection with the discussion above of certain provisions in the bill, the restrictive provisions could be made to apply only to suits other than those under Section 1964(c) (1) (A).

persons a remedy for injuries from repeated criminal acts. The proposed requirement that, in such cases, the defendant need only have acted consciously and wantonly to be liable appears to be at odds with the present civil RICO requirement that the defendant's actions constitute criminal acts in violation of Section 1962.

* * *

In sum, Mr. Chairman, we do recognize that a legislative compromise has been developed with respect to private actions. Subject to our requests for changes in the parts of the bill that affect governmental criminal and civil RICO actions, and our comments regarding the small investors' provisions, we are inclined to interpose no objection to the bill's compromise on private actions, including the consumer provision addressed at Point Seven.

Mr. Chairman, that concludes my prepared remarks, and I would now be happy to try to address any questions which you or the Members of the Committee might have.



U.S. Department of Justice

Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

18 NOV 1987

Honorable Howard Metzenbaum
Chairman
Subcommittee on Antitrust, Monopolies
and Business Rights
Committee on the Judiciary
United States Senate
Washington, D. C. 20510

Dear Mr. Chairman:

This responds to your letter of November 2, 1987, to Assistant Attorney General Weld forwarding questions posed by Senator Thurmond with respect to the hearing on S. 1523.

With respect to Senator Thurmond's first question as to whether S. 1523 goes far enough in curbing abuses of civil RICO, we quite frankly prefer the "prior conviction predicate" approach set out in the draft legislation which we proposed on July 22, 1986. We believe, however, that enactment of the "prior conviction" approach is no longer feasible and that S. 1523, with amendments, represents an acceptable compromise of the difficult issues it addresses.

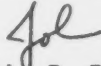
Regarding the intent of Congress in approving the treble damage civil action in 1970, the legislative history is far from clear. We believe, however, that, although Congress may have anticipated use of 18 U.S.C. 1964(c) against other than traditional organized crime figures, the Members voting for the proposal would be amazed by the variety of creative uses to which the civil RICO statute has been put by ingenious plaintiffs. There is, of course, precedent for treble damages in antitrust and some other laws and we do not object to retention of a treble damage remedy if modified as suggested in S. 1523.

Finally, our objection to the so-called "small investor exception" is one of principle, as Assistant Attorney General Weld noted at the hearing. At bottom, the "small investor exception" suggests that legal remedies available to litigants should vary depending upon the financial status of the plaintiff. If enacted, a "small investor" plaintiff would be entitled to actual damages plus "double punitive damages" while other

similarly situated plaintiffs, who might have suffered from the same fraud perpetrated by the same defendant, would be entitled only to actual damages. To make statutory remedies depend upon such a distinction offends our concept of equal justice under law and could raise a question under the Equal Protection Clause of the Constitution. In short, we believe that the federal securities laws previously enacted by Congress provide amply for all potential plaintiffs, without regard to household income or portfolio size, and that to attempt to afford "small investors" especially favorable remedies under the civil RICO statute is both inadvisable and unnecessary.

We appreciate this opportunity to comment further and hope you will let us know if you require further information.

Sincerely,



John R. Bolton
Assistant Attorney General

cc: Honorable Strom Thurmond
Ranking Minority Member
Committee on the Judiciary

Senator METZENBAUM. Thank you very much.

Mr. Cameron Holmes.

Mr. HOLMES. Good afternoon, Chairman Metzenbaum, Senators. I am Cameron Holmes, Assistant Chief Counsel of the Financial Remedies Unit, Arizona Attorney General's Office. I am here on behalf of the National Association of Attorneys General.

The Attorney General of Arizona, Bob Corbin, is the Chairman of the RICO Subcommittee of the National Association of Attorneys General. The National Association of Attorneys General appreciates this opportunity to present our views today, and Attorney General Corbin regrets that pressing matters in the State of Arizona have prevented his personal appearance.

I have submitted written testimony on behalf of the National Association favoring RICO reform, favoring adoption of the RICO Act of 1987, which is the act introduced on the House side by Representative Conyers, but vigorously opposing S. 1523 introduced by Senator Metzenbaum.

I would like to say, Senator Metzenbaum, that over the years the National Association of Attorneys General has appreciated your leadership on many consumer protection and antitrust issues of vital concern to the 50 States. The Association wants to continue to work with you and the members of this Committee. We have especially appreciated your understanding of law enforcement concerns and regret that we must respectfully differ on the RICO issue.

I have submitted a lengthy written statement for the Committee's reference. I wish—

Senator METZENBAUM. Your entire statement will be included in the record.

Mr. HOLMES. Thank you, Senator.

I wish only to review the National Association of Attorneys General position briefly and then add the serious law enforcement concerns that we perceive with this legislation.

The National Association of Attorneys General supports reform that would preserve RICO's effectiveness criminally as a prosecution weapon against sophisticated forms of organized crime, white-collar crime, as well as terrorism, environmental pollution, and organized crime; preserve RICO's effectiveness civilly as a weapon against fraud that may be used by Federal, State and local units of Government; and perhaps most importantly, preserve RICO's effectiveness civilly as a weapon against fraud that may be used by the victims of fraud themselves.

The National Association believes that the extensive work on the RICO issue done in the preparation of the House bill, known as the Racketeering Influenced and Corrupt Organizations Act of 1987, is sensitive to both commercial and governmental concerns. RICO, responsibly applied, is favorable to both.

Arizona's civil RICO statute is considerably broader than federal RICO. Far from the evolving restrictions on the pattern requirement under federal RICO, Arizona has no pattern requirement. A single act of racketeering supports a cause of action for treble damages in Arizona.

Arizona's business community supports RICO enthusiastically, and for commercial reasons. As the Arizona Supreme Court stated in a leading Arizona civil racketeering case, "There is a moral im-

perative to provide redress for those injured. Further, when out-of-State investors are swindled by Arizona enterprises, the reputations and businesses of the majority of honest business people within the State are harmed. That this State is willing to provide aid in redressing these wrongs is evidence that the State is serious in its fight to eradicate organized crime. This evidence may instill confidence in nonresidents seeking to invest in the legitimate businesses of this State."

I submit, Mr. Chairman, that confidence in our investment industry has never been more necessary than it is today. The debate about civil RICO seems to me to boil down to a debate over resources.

We do not oppose the preservation of resources of commerce, but I would like to draw to your attention a resource that perhaps has not received your attention, and that is the resource of the new generation of law enforcement officials like myself who have entered law enforcement with RICO as their beacon.

RICO serves the law enforcement community as a beacon of social justice, as a statute that stands for justice for all, with no defendant beyond the law.

Senator METZENBAUM. Thank you very much, Mr. Holmes.
[Statement follows:]

Statement
of
National Association of Attorneys General
on
RICO Reform
S. 1523, 100th Congress, 1st Sess. (1987)
Before the
Senate Judiciary Committee
1987

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Statement
of
National Association of Attorneys General
on
RICO Reform
Before the
Senate Judiciary Committee
1987

Mr. Chairman, Members of the Committee, our testimony today is given on behalf of the National Association of Attorneys General.

The National Association of Attorneys General (hereafter "the Association") was founded in 1907 for the purpose of fostering communication and cooperation among the state's chief legal officers and their staffs. Since then, the Association has served as a clearing house of information, provided research and technical assistance, and has conducted analysis of policy and legislative issues pertaining to law and law enforcement.

Representing the chief legal officers of the states, the Association testifies today on the subject of "RICO Reform." The Association testified in the 99th Congress. See Oversight on Civil RICO Suits, Hearings before the Senate Judiciary Committee, 99th Cong., 1st Sess. 342-525 (1985) (Oversight); RICO Reform, Hearings before House Judiciary Subcommittee on Criminal Justice, 99th Cong., 1st and 2nd Sess. 562 (1985-86) (Reform). This subject takes on special meaning in light of action of the 99th Congress, in its closing hours, of failing to pass reform legislation by only two votes. 132 Cong. Rec. S

16704 (daily ed. October 16, 1986) (failure of passage of H.R. 5445 in the form of Amendment No. 3479 to the continuing appropriation act by a vote of 47 to 44).

The National Association of Attorneys General supports the basic RICO concept and has passed resolutions dealing with RICO. These resolutions are attached to this statement as Exhibits "A" and "B".

In summary, the Association supports efforts to clarify or strengthen RICO. It supports RICO reform that would --

1. preserve RICO's effectiveness criminally as a prosecution weapon against sophisticated forms of organized or white-collar crime as well as terrorism or other violence-prone groups.
2. preserve RICO's effectiveness civilly as a weapon against fraud that may be used by federal, state and local units of government, and
3. preserve RICO's effectiveness civilly as a weapon against fraud that may be used by other similar victims of crime.

At the same time, the Association opposes any effort to circumscribe RICO in these vital areas. As such, the Association opposes, almost without exception, the provisions of S. 1523. Nonetheless, the Association supports responsible efforts to curtail demonstrated abuse of civil RICO by irresponsible private litigants. As such, the Association supports, in general, the provisions of The Racketeer Influenced and Corrupt Organization Act of 1987 (hereafter "the 1987 RICO Act").

I. The Scope and General Use of RICO

Federal RICO creates three substantive prohibitions:

- (1) investing in an "enterprise" with the proceeds of a "pattern of racketeering,"
- (2) acquiring an "enterprise" by a "pattern of racketeering," and
- (3) operating an "enterprise" by a "pattern of racketeering."

"Enterprise" is defined to include corporations, unions, governmental units, and lawful and illicit associations. (18 U.S.C § 1961(\$)).

"Pattern of Racketeering" is defined to include offenses dealing with:

- (1) personal violence,
- (2) the provision of illegal goods and services, that is, drugs, prostitution, etc.,
- (3) corruption in private (corporate and union) or public life, and
- (4) various forms of criminal fraud.

(18 U.S.C. § 1961(1)).

The statute itself imposes criminal sanctions on violations of its substantive prohibitions:

- (1) imprisonment and fine (20 years and \$25,000), and
- (2) criminal forfeiture of:
 - (a) proceeds of transactions,
 - (b) bases of power.

(18 U.S.C. § 1963).

In light of the Criminal Fine Enforcement Act of 1984, the fine may also be:

- (1) \$250,000, if an individual is convicted,
- (2) \$500,000, if other than an individual is convicted, or
- (3) twice the loss or twice the gain.

(18 U.S.C. § 3623(a)(3), (b)(3), or (c)(1)).

The rights of innocent parties, i.e., those without knowledge, and victims are explicitly protected.

The statute authorizes civil injunctive suits against those who engage in racketeering; it also authorizes treble or triple damages in civil suits against those who engage in racketeering. (18 U.S.C. § 1964).

Since 1970, similar legislation has been enacted in 27 states. Attached to this statement as Exhibit "C" is a comprehensive analysis of federal RICO and the state statutes. Currently, RICO-type legislation is also pending in a number of other states.

The federal statute and its state counterparts have been successfully employed in a variety of organized crime prosecutions (United States v. Brooklier, 685 F.2d 1208, 1213 (9th Cir. 1982), cert. denied, 459 U.S. 1206 (1983), "members of La Costa Nostra, a secret national organization engaged in a wide range of racketeering activities, including murder, extortion, gambling and loansharking."), political corruption cases (United States v. Mandel 602 F.2d 653 (4th Cir. 1979),

cert. denied, 445 U.S. 961 (1980), Governor of Maryland), and white-collar crime prosecutions (United States v. Marubeni American Corp., 611 F.2d 763 (9th Cir. 1980), Japanese corporation: fraud and bribery).

The statutes also have been employed successfully against violent groups generally, including outlaw motorcycle gangs, United States v. Watchmaker, 761 F.2d 1459, 1463 (11th Cir. 1985), cert. denied, 106 S.Ct. 879 (1986) ("Outlaw Motorcycle Club"); United States v. Rubio, 727 F.2d 786, 790 (9th Cir. 1983) ("Hells Angels Motorcycle Club"), and terrorist groups, United States v. Bagaric, 706 F.2d 42 (2d Cir., cert. denied, 104 S.Ct. 283 (1983), (Croatian nationalist terrorists). A study by the Anti-Defamation League of B'nai B'rith concluded that the hate movement -- neo-Nazi, Ku Klux Klan, and other violent racist and anti-Jewish groups -- is suffering serious setbacks in part as a result of RICO prosecution and various civil suits. See generally, The Hate Movement Today (ADL Special Study 1987). Congress must do nothing that would undermine RICO's promise in this crucial area. See also N.Y. Times, Dec. 30, 1985, p. 1, col. 1 (conviction under RICO of nine men and one woman, members of the "Order," a racist and anti-semitic group, accused of multiple murders, armed robberies, counterfeiting, weapons offenses, and arson); id., Sep. 6, 1985, p. 17a, col. 3 (conviction under RICO of leader of "Covenant, the Sword, and the Arm of the Lord," a militant white supremacist group).

Increasingly, RICO civil provisions are being used successfully at the federal and state level by the federal government and state and local governmental units victimized by conduct prohibited by the statute. See, e.g., State of Okla. ex re. Department of Human Services v. Children's Shelter, Inc., 604 F.Supp. 867, 870-71 (W.D. Okla. 1985) (medicaid fraud); Comm'n v. Cianfrani, 600 F.Supp. 1364, 1368-69 (E.D. Pa. 1985) (treble damage award against state senator for "ghost" workers); Anchorage v. Hitachi Cable Ltd., 547 F.Supp. 633 (D. Alaska 1982) (bribery of purchasing agent). At the state level, RICO has been most successfully implemented in Arizona, Florida, Oregon, New Jersey, New Mexico and Pennsylvania. The Florida RICO Act, for example, has been used most often in the areas of controlled substances, but has also been used successfully against the economic bases of pornography, prostitution, gambling, theft, and fraud enterprises. Similarly, the success of the office of the Arizona Attorney General in its use of the Arizona RICO statute is impressive. New York, too, is expected to make vigorous use of its new criminal RICO statute.

For criminal prosecutions, see, e.g., Carlson v. State, 405 So.2d 173, 174 (Fla. 1981) (house of ill fame); Dorsey v. State, 402 So.2d 1178, 1180 (Fla. 1981) (drugs); State v. Whiddon, 384 So.2d 1269, 1270 (Fla. 1980) (theft, burglary, arson, and arson to defraud); Moorehead v. State, 383 So.2d 629, 630-31 (Fla. 1980) (auto theft). For civil actions, see, e.g., Arizona ex rel. Corbin v. Pickrell, 136 Ariz. 589, 591, 667 P.2d 1304, 1306

(1983) (securities fraud); Banderas v. Banco Central del Ecuador, 461 So.2d 265 (Fla. Dist. Ct. App. 1985) (foreign exchange fraud).

The federal RICO statute has played a major role in the interpretation of state legislation. See e.g., Baines v. Superior Court, 688 P.2d 1037, 1040 (Ariz. Ct. App. 1984) ("[i]n the absence of any Arizona cases, we will look to federal decisional law for guidance"); Roush v. State, 413 So.2d 15, 20-21 (Fla. 1982) (constitutionality of RICO-type civil remedies upheld relying on federal decisions); Moorehead v. State, 383 So.2d at 630-31 (constitutionality of "pattern" in Fla. RICO statute upheld relying on federal decisions.) This approach is consistent with general principles of statutory interpretation. See, e.g., People v. Wahl, 716 P.2d 123, 128 (Colo. 1986) (Colorado wiretap law read like federal wiretap law). There has been, however, a disturbing tendency on the part of some federal judges to give to state RICO legislation an unduly narrow interpretation, despite substantial differences in the language of state statutes and crucially different policy considerations. Compare Arizona ex rel Corbin, *supra*, (Arizona RICO not necessarily to be circumscribed like Federal RICO, since federalism concerns inapplicable), with Behunin v. Dow Chemical, 650 F.Supp. 1387, 1390 (D. Colo. 1987) (Colorado "pattern" narrowly construed like federal RICO). This approach is not consistent with general principles of statutory interpretation. See, e.g., Jensen v. Intermountain Health Care, Inc., 679 P.2d

903, 904-05 (Utah 1984) (adopted provisions must be "harmonize[d]" with "additional sections"; presumption of similar intent gives way when "material" changes are made; decisions of sister jurisdiction after date of adoption not "binding").

Other states and localities are also moving to implement their state legislation as well as to bring federal suits. The Association invites this Committee, therefore, to study these enforcement programs as part of its hearings.

Since the 99th Congress, new legislation has been introduced in the Senate. The principal item of legislation concerning this Committee is S. 1523, introduced by Senator Metzenbaum. This statement will focus on the key provisions of S. 1523. It also will contrast the provisions of S. 1523 with those of H.R. 3240, the Racketeer Influenced and Corrupt Organizations Act of 1987, introduced in the House by Congressmen Conyers and Edwards. Any discussion, however, of alleged RICO abuse in the area of commercial fraud litigation -- the major focus of calls for "reform" -- must first be put into the larger context of the problem of fraud in our society.

II. The Scope of Fraud and Allegations of Civil RICO Abuse

The current controversy over federal RICO has not centered on its criminal provisions or its possible civil application in the areas of violence, the provision of illicit goods and services, or the corruption of governmental entities or unions.

Indeed, Congress has shown its support for the RICO concept most recently in the passage of the Comprehensive Crime Control Act of 1984, Pub. L. No. 98-473, 98 Stat. 1837 (1984), which extensively rewrote its criminal sanctions, strengthening its forfeiture provisions and adding a number of new predicate offenses. Similarly, in the Anti-Drug Abuse Act of 1986, P.L. No. 99-570, Stat. - (1986) in Subtitle D - The Assests Forfeiture Amendments Act of 1986, Congress greatly strengthened RICO by providing for the forfeiture of substitute assets. The controversy over RICO has focused almost exclusively on private suits brought in the commercial fraud area. Most stridently, for example, voices cry out that RICO is anti-business. Nothing could, of course, be more self-serving or further from the truth. Former Treasury Secretary W. Michael Blumenthal put it well, "[t]he misbehavior of a large corporation makes news because the majority do not misbehave [but those who are] ethically strong and morally clean [should be the first to denounce those who are not for they] threaten the survival of the free enterprise system." White Collar Crime: The Problem and The Federal Response, Subcommittee on Crime, House Judiciary Comm., 95th Cong. 2d Sess., 15 (Comm. Print 1978). That major corporations do engage in illegal practices, however, cannot be seriously questioned. A survey of 1,043 major corporations between 1970 and 1980 indicated that 117 had significant convictions or consent decrees for 98 antitrust violations, 28 cases of kickbacks, bribery, or illegal rebates, 21 instances of

illegal political contributions, 11 cases of fraud, and 5 cases of tax evasion.

Legitimate business people, in fact, have little to fear from federal or state RICO legislation. Neither makes criminal conduct that is not already criminal under its predicate offenses. Both merely provide enhanced sanctions and new civil enforcement mechanisms. Legitimate business people do not perpetrate fraud; they are victimized by it. Good faith commercial disputes, moreover, do not constitute criminal fraud. Nothing in RICO provides to the contrary. See, e.g., Durland v. United States, 161 U.S. 306, 314 (1895) (good faith defense to mail fraud); United States v. Martin-Trigona, 684 F.2d 485, 492-93 (7th Cir. 1982) ("[G]ood faith, or the absence of an intent to defraud, is a complete defense to a charge of mail fraud"). The opponents of RICO legislation object, in effect, to the effective enforcement of present law.

While it may be that some RICO suits have been brought by unethical plaintiff's lawyers hoping to obtain quick settlements by the filing of strike suits, that characterization may not be made of all, or even most, RICO litigation. Major corporations that have sued under RICO, for example, include I.B.M., Crocker National Bank, Standard Oil of Indiana, Armco Steel, Pepsi-Cola Bottling Company, Banker's Trust Co., Aetna Casualty and Security Co., Allstate Insurance Co., and State Farm Fire and Casualty Co. I.B.M., for example, sued Hitachi, Ltd., under RICO for the theft of computer software; the suit was settled

for upwards of \$200 million. Similarly, the Crocker National Bank litigation against Lehman Brothers, Rockwell International, and Singer, Hunter, et al., a law firm, involved a \$225 million computer leasing fraud; it was settled for \$65 million.

No one knows how much fraud is practiced against the federal government in the defense contract and procurement area. A generally accepted estimate does not even exist. That the figure must be enormous, however, is underlined by the guilty plea of the General Electric Co. to defrauding the Pentagon on its Minuteman missile contract. Other investigations involving G.E. are pending. Similarly, the General Dynamics Corporation, another of the nation's largest defense contractors, has acknowledged giving Admiral Hyman Rickover over \$67,000 in "gratuities" between 1961 and 1977. Indeed, in 1985, Secretary of the Navy, John F. Lehman, Jr., suspended for a period of time all new contracts with the Corporation because of "pervasive" business misconduct. In addition, the Inspector General of the Pentagon has informed Congress that forty-five defense contracting firms are under investigation. The allegations against 9 of the top 10 largest defense contractors include: cost mischarging, labor mischarging, subcontractor kickbacks, product substitution, security compromise, defective pricing, cost duplication, false claims, supply accountability, gratuities, bid rigging, and bribery. Similar problems exists with fraud practiced against state and local governments in the contract procurement area.

A general estimate of fraud -- both by insiders in the government and recipients of benefits -- in other federal government benefit programs is put at \$2.5 to \$25 billion. If similar estimates -- 1 to 10% -- were made of the scope of fraud in state and local expenditures -- now running at the annual rate of \$352 billion -- it takes but little imagination to work out its staggering size. Specialized estimates of individual programs make the higher figure more likely. Medicaid beneficiary fraud, for example, is put at \$1.2 billion; medicaid provider fraud amounts to \$715 million. Medicare fraud amounts to \$1.5 billion. That this record represents only the tip of the iceberg seems clear. A General Accounting Study in 1980 tragically concluded, "Most fraud [against government] is undetected. For those . . . committing fraud, the chances of being prosecuted and eventually going to jail are slim The sad truth is that crime against the Government often does pay." U.S. General Accounting Office, Fraud in Government Programs - How Expensive Is it? - How Can It Be Controlled, iii (1980).

Fraud against the government exists, moreover, not only on the expenditures side. Tax evasion, too, is a major problem. Estimating the size of the underground economy is difficult. The federal tax gap for 1986 was estimated at \$103 billion, up from \$39 billion just ten years ago. Recently, the Internal Revenue Service contracted for select studies, particularly in the area of illicit activities. See e.g., ABT Assoc., Inc.,

Unreported Taxable Income From Selected Illegal Activities, 61, 108, 147 (1984) (drugs, \$26.64 billion; gambling, \$2.39 billion; prostitution, \$11.58 million). In addition, other studies have been made, two of which are of particular concern here, as each involves organized crime, a central, but not exclusive, purpose of RICO: cigarette smuggling and gasoline tax evasion.

The ABT study put the loss of revenue for 1982 for cigarette smuggling at \$202 million. Id. at 252. Estimates for 1978 of multi-million dollar tax losses in this area led to the passage of 18 U.S.C. § 2341 et seq., the Contraband Cigarette Act, 62 Stat. 2465 (1978). See e.g., H.R. 95-1629, 95th Cong., 2nd Sess. 4 (1978) (34 states losing \$400 million each year). The House Judiciary Committee found that "organized crime involvement in cigarette bootlegging . . . [has] become a serious national problem which state law enforcement efforts have failed to adequately deter." Id. Significantly, the 1978 Act made violations of Sections 2341-2346 predicate offenses under RICO, subject to its criminal and civil sanctions. The lower figures today are the result of the deterrent impact of the 1978 Act and its vigorous enforcement. Cigarette Tax Evasion: A Second Look: A.C.I.R., 2-4 (1985). Obviously, no action should be taken that would undermine the deterrent impact of RICO--criminal or civil.

Similarly, estimates place the loss of gasoline sales tax at \$3 billion a year--\$1 billion federal and \$2 billion states. Newsday, Monday, September 8, 1986, p. 7, col. 1. Heavy

organized crime involvement is also present. Id. (Colombo, Luchese, and Geneovese crime families active). See also The Public Report of the Sixth Statewide Grand Jury of Florida, 5-12 (1985) ("organized scam to steal fuel tax money"); Florida Sun Sentinal, January 24, 1986. (Colombo family \$40 million in gas taxes in 16 month period). Systemic sales tax evasion, however, is not limited to organized crime. It is part of an equally troublesome white-collar crime phenomenon. See, e.g., New York Times, January 9, 1987, p. 21, col. 1 (Van Cleef & Arpels, Inc., jeweler on Fifth Ave., \$5 million in sales tax evasion scam, including such prominent people as Leona Helmsley); id., December 16, 1986, p. 1, col. 4 (Bulgari, operator of Pierre Hotel on Fifth Ave., \$1.5 million in sales tax evasion; Cartier, jeweler on Fifth Ave., similar conviction).

More generally, fraud is estimated to cost the nation's businesses and individuals upwards of \$200 billion each year. Annual Report of the Attorney General of the United States at 42 (1985). Securities theft and fraud costs \$48 billion. Movie piracy costs \$1.2 billion. Records and tape piracy cost \$400 million. Commodities investment fraud costs \$200 million. Recent investigations indicate that as much as \$100 million may have been bilked from buyers of mobile homes, many of which were federally insured. Bank fraud, particularly by insiders, is also deeply disturbing. In the 1980-81 period, the failure of 105 banks and savings and loans cost one billion dollars. Roughly one-half of the bank failures and one-quarter of the

savings and loan collapses had, as a major contributing factor, the criminal activities by insiders, few of whom, according to the findings of a study by the Barnard Committee, were adequately sanctioned, criminally or civilly. In 1984, the Committee noted:

Despite such enormous losses, neither the banking nor the criminal justice systems impose effective sanctions or punishment to deter white-collar bank fraud. The few insiders who are singled out for civil sanctions by the banking agencies are usually either fined de minimis amounts or simply urged to resign. The few who are criminally prosecuted usually serve little, if any, time in prison for thefts that often cost millions of dollars. Federal Response to Criminal Misconduct and Insider Abuse in the Nation's Financial Institutions, Committee on Government Operations, H. R. Rep. No. 1137, 98th Cong., 2nd Sess. at 5 (1984).

Since then, bank failures have continued their five year course--more than 100 per year--breaking all post-Depression records. The \$1.8 billion FDIC trust fund, which insures banks, may shrink dramatically over the next year. 1500 institutions are on the FDIC "sick" list. The General Accounting Office suggests that the FSLIC, which insures savings and loan associations was, until a recent congressional rescue plan, "insolvent" according to generally accepted accounting principles. N.Y. Times, Apr. 2, 1987, p. 30, col. 1. Most banks, too, do not have the financial resources or the expertise to protect themselves from sophisticated schemes to defraud. According to testimony of the FDIC last year, 97% of the federally insured banks have assets of less than \$500 million; 84% less than \$100 million; 66% less than \$50 million. Oversight at 216.

Ultimately, many of the costs of these kinds of fraud are passed on to the rest of us. Insurance fraud, for example, annually costs \$11 billion, and since the typical insurance company must generate \$1.25 in premiums for every dollar it pays out, the bill that the nation must meet amounts to \$13.75 billion. Indeed, the "insurance crisis" that has led legislatures to rewrite our liability laws to curtail personal injury litigation might be better dealt with by enforcing vigorously our laws against fraud. Compare N.Y. Times, Mar. 2, 1986, col. 1, p. 20 (industry said to lose \$5.5 billion or make \$1.7 billion) with N.Y. Times, Feb. 9, 1987, col. 1, p. 1 (insurance crisis ended with insurance generally available, although at higher rate, and profitably present for industry). Much insurance fraud, too, is systemic. In Southern California alone, it is estimated that some 40 insurance fraud rings, run by crooked lawyers and doctors, bilk the insurance industry out of \$200 million a year. While the cost of vexatious litigation is generally spread throughout society by directors' and officers' liability insurance, too often the costs of fraud are not shared through insurance and rest on the shoulders of the victims, who can ill-afford to carry or sustain them. Indeed, in light of Ohio's experience with the failure of E.S.M. Government Securities, Inc., including a paid for false audit report, and the repercussions in the savings and loan industry and on the gold market, no one ought seriously to contend that such fraud is a "garden variety" problem that may be "weeded"

with business-as-usual legal techniques. See Chicago Tribune, Jan. 27, 1987, p. 2, col. 1 (\$315 million collapse lead to multi-million dollar losses to investors, including several municipal governments, and a crisis in Ohio's savings and loan industry.) Those individuals exist, of course, who would agree with the 18th century caveat emptor philosophy expressed by Justice Dennison in Queen v. Jones, 91 Eng. Rep. 330, 1 Salk. 379 (1704): "[W]e are not to indict one man for making a fool of another." But that day has passed. Modern notions of consumer protection have made that attitude outmoded.

The Second Circuit in its Sedima opinion suggested that it was "extraordinary if not outrageous" to bring a civil RICO suit against legitimate businesses; the court cited among its examples of such legitimate businesses, E.F. Hutton & Co., and Merrill Lynch. Sedima, 741 F.2d 482, 487 (2nd Cir. 1984), rev'd., 473 U.S. 479 (1985). The guilty plea of E. F. Hutton to illegally overdrawing its bank accounts by more than \$10 billion (obtaining a free ride averaging \$150 million a day) indicates how unwise the Circuit Court's illustration was. So, too, do the arrests and guilty pleas in the growing insider information scandal on Wall Street. N.Y. Times, Feb. 13, 1987, p. 1, col. 6, (3 leading brokers arrested) (Goldman, Sachs & Co.; Kidder Peabody & Co.; one broker, the former head of Arbitrage at Merrill, Lynch & Co.). Justice White in the Supreme Court's Sedima decision (473 U.S. at 499) put it well: "'[L]egitimate'

. . . enterprises . . . enjoy neither inherent incapacity for criminal activity nor immunity from its consequences."

Public enforcement, with its principal reliance on the criminal law, cannot be relied on to do the whole job of policing fraud. We must be candid about the limitations of the criminal justice system in the white-collar area. Resources available for investigation and prosecution are scarce. The common law criminal trial is ponderous. The cases are complex. Offenders will most often be treated as "first offenders" even if they actually engaged in a pattern of behavior over a substantial period of time. A few convictions will yield only a minimal deterrent effect. J. Conklin, Illegal But Not Criminal: Business Crime in America, 129 (1977) rightly concludes:

[T]he criminal justice system treats business offenders with leniency. Prosecution is uncommon, conviction is rare, and harsh sentences almost nonexistent. At most, a businessman or corporation is fined; few individuals are imprisoned and those who are serve very short sentences. Many reasons exist for this leniency. The wealth and prestige of businessmen, their influence over the media, the trend toward more lenient punishment for all offenders, the complexity and invisibility of many business crimes, the existence of regulatory agencies and inspectors who seek compliance with the law rather than punishment of violators all help explain why the criminal justice system rarely deals harshly with businessmen. This failure to punish business offenders may encourage 'feelings of mistrust toward community morality, and general social disorganization' in the general population. Discriminatory justice may also provide lower class and working class individuals with justifications for their own violation of the law, and it may provide political radicals with a desire to replace a corrupt system in which equal justice is little more than a spoken ideal. (citations omitted).

The funding of the Securities and Exchange Commission, for example, has increased since 1979, but its staffing has decreased, and its pending investigations are down. Yet the number of shares traded on the New York Stock Exchange has shot up 300% since 1977; the number of first time registrants has increased by 206%. See generally, U. S. General Accounting Office, Statistics on SEC's Enforcement Program (1985). Even among legitimate brokerage firms, the incentive structure for commissions encourages a fraud known as "churning," trading stock without regard for investment objectives. Similarly, the futures industry in the United States has grown tremendously in recent years. The 139.9 million futures contracts traded in 1983 represent a level of trading activity 15 times greater than that reached in 1968. The value of contracts traded exceeds \$5 trillion a year. Nevertheless, the resources of the Commodities Futures Trading Commission have remained relatively constant. Some would suggest that the industry is a scandal waiting to happen, for the Commission "is thoroughly out-gunned in the ongoing battle against commodity fraud." Commodity Investment Fraud, Senate Comm. on Governmental Affairs, S. Rep. No. 97-495, 97th Cong., 2nd Sess. 10 (1983). In addition, accounting firms, once thought to play the role of outside watchdogs, are under heavy competitive pressure to go along with questionable annual reports and are increasingly losing their independence, since they also offer management consulting advice, as the testimony before the Dingle Committee so amply shows. See Forbes, May 4,

1987 at 57. The need for more effective deterrents to fraud in the world of legitimate business is, therefore, manifest.

Clearly, fraud--of all types--is a national problem that belongs, not only in state courts, but also in the national courts, along with price fixing, copyright infringement, and related business offenses. Dante persuasively suggests that crimes of fraud are, in fact, worse than crimes of violence: "because fraud is the proper evil of man, it more displeases God. And therefore the fraudulent stand below; and great pain assails them." Inferno, Canto 11, 25-27. Civilization requires trust. Fraud undermines it. No civilized society can lightly tolerate it. No less than the integrity of the free enterprise system is at stake.

The perspective of history in the areas of antitrust and securities regulation is enlightening. Congress passed the Sherman Act in 1890, principally to attack the oil, tobacco and sugar trusts, but it applied to all contracts in restraint of trade, not just those entered into by the Rockefeller family in connection with the founding of the Standard Oil Company. In addition, it was not until the era of the New Deal that the private enforcement mechanism of the antitrust statutes began to come into its own. Today, if our markets are free, it is principally because of private enforcement. Between 1960 and 1980, of the 22,585 civil and criminal antitrust cases, 84% were instituted by private plaintiffs.

The promise of the 1890 statute was, however, only slowly redeemed. It took until 1910 for the government to bring and the Supreme Court to uphold the break up of the Standard Oil monopoly. Standard Oil Co. v. United States, 221 U.S. 1 (1910). The thrust of scholarly analysis of the Act's history places that disuse at the door of judicial hostility inflamed by the business community itself.

The historical parallels under RICO are haunting. The government only recently has brought a prosecution under RICO to break up the commission headed by the five families of organized crime in New York City, even though the Commission and its membership, including 5 of 9 of the defendants in the 1985 indictment, were described and named in the 1969 Senate report on RICO. S. Rep. No. 91-617, 91st Cong., 1st Sess. 38-42 (1969).

The Supreme Court - and the nation, including the business community - has, however, come to see the Sherman Act as "the Magna Carta of free enterprise," as "important to the preservation of economic freedom and our free enterprise system as the Bill of Rights is to the protection of our fundamental personal freedoms." United States v. Topco Associates, Inc., 405 U.S. 596, 610 (1972). RICO and the antitrust statutes are well-integrated. Former Assistant Attorney General for Antitrust, Donald Turner, observed, "There are three possible kinds of force which a firm can resort to: violence (or the threat of it), deception, or market power." C. Kaysen and D. Turner, Antitrust Policy, 17 (1954). RICO focuses on the first

two; antitrust focuses on the third. Society needs them both, if its markets are to be not only free, but honest. See also, American C & L Co. v. United States, 257 U.S. 377, 414 (1921) (Brandeis, J.) ("Restraint may be exercised through force or fraud or agreement.")

Fifty years ago, following the brilliant expose of Ferdinand Pecora, Congress passed the securities acts to deal with abuses, frauds, and deceptions in certain limited areas of the marketplace. The acts, however, encountered both open and undercover resistance from brokers and investment bankers. The 1933 Act was, for example, thought to be so "draconian" that it would "dry up the nation's underwriting business and that 'grass would grow in Wall Street.'" D. Rather, Securities Regulation, 80 (1982). Early decisions by the pre-New Deal Supreme Court also reflected a similar hostility. See, e.g., Jones v. Securities Comm'n., 298 U.S. 1 (1935) (subpoena to testify properly quashed). Justices Cardozo, Brandeis and Stone, dissenting in Jones, protested the Court's narrow reading of the 1933 Act, for they knew that the criminal law alone, as Justice Jackson was later to observe, "had long proved futile to reach the subtler kinds of fraud at all, and able to reach grosser fraud, only rarely." R. Jackson, The Struggle for Judicial Supremacy, 152 (Vintage 1941). Today, ironically, those acts are what the securities industry relies upon in attacking RICO and defending the legal status quo. In fact, as with the antitrust statutes, both are needed.

Civil RICO builds upon the experience of the last half century in the antitrust and securities areas and generalizes it across the marketplace. As the antitrust acts seek to maintain economic freedom in the marketplace, RICO seeks, in the fraud area, to promote integrity in the marketplace. RICO is, therefore, neither anti-business nor pro-business. It is pro-victim.

Legitimate business people, like lawyers, doctors, prison officials, and police officers, cannot expect to be freed from their legal duty to respond to well-plead complaints. As Justice Brandeis observed, "Lawsuits . . . often prove to . . . [be] groundless; but no way has been discovered for relieving a defendant from necessity of a trial to establish the fact." Myers v. Bethlehem Shipbuilding Corp., 303 U.S. 41, 51-52 (1938). Justice Marshall in Sedima (473 U.S. at 504), however, suggests that private litigation, unlike public litigation, is "unrestrained." We disagree. Under the Model Code of Professional Responsibility, an attorney may be subject to discipline for filing a suit on behalf of his client for the purpose of harrassing or maliciously injuring another. (DR7-102(A)(1)). Similarly, he may not knowingly advance a claim or defense unwarranted by existing law, unless he can make a good faith argument for its extension, modification, or reversal. (DR7-102(A)(3)). Defendants subjected to meritless civil claims, moreover, are not without recourse. Tort remedies include abuse of process, which is applicable where suits are

filed to force nuisance settlements. See, e.g., Bull v. McCuskey, 86 Nev. 706, 615 P.2d 957 (1980) (suit by doctor charging malpractice litigation brought by attorney improper). If these traditional ethical injunctions and tort remedies are not adequate, it is these remedies and not substantive rights that should be reformed. Recently, Justice Stevens aptly commented: "Frivolous cases should be treated as exactly that, and not as occasions for fundamental shifts in legal doctrine. Our legal system has developed procedures for speedily disposing of unfounded claims; if they are inadequate to protect [individuals] from vexatious litigation, then there is something wrong with those procedures, not with the law" Over v. Ronwin, 104 S.Ct. 1989, 2012 (1984), rehearing denied, 104 S.Ct. 3564 (1984).

Those who express a concern with frivolous suits under civil RICO have the burden of proving that a substantial number have been filed, that existing safeguards against such suits are not adequate to remedy them, that new safeguards against such suits which are adequate cannot be designed, and that the detriment from these suits outweighs the benefit from legitimate suits. None of these burdens has been met. In fact, a study of the United States Judicial Conference in 1983 concluded that "the existing tools [were] sufficient [although] not fully understood or utilized." Administrative Office of the United States Courts, 1983 Annual Report of the Director: Report of the Judicial Conference of the United States, 56 (1983). See

generally Reiter v. Sonotone Corp., 442 U.S. 330, 344-45 (1979) (fear of frivolous suits unjustified in light of tools available). For application in RICO cases, see WSB Elec. Co. v. Rank & File Comm. to Stop the 2-Gate System, 103 F.R.D. 417, 420-21 (N.D. Cal. 1984) (sanctions under Fed. R. Civ. P. 11 imposed for frivolous RICO claim based on picketing); Gordon v. Heimann, 715 F. 2d 531, 539 (11th Cir. 1983) (bad faith counsel fee award in civil RICO appeal); King v. Lasher, 572 F.Supp. 1377, 1385 (S.D.N.Y. 1983) (bad faith counsel fee award in civil RICO suit). Frivolous defenses to valid RICO and other claims may also be made the subject of sanctions. Miller v. Affiliated Financial Corp., 600 F.Supp 987, 990-92 (N.D. Ill. 1984).

Justice Marshall in Sedima (473 U.S. at 506) also suggests that "a prudent defendant, facing ruinous exposure [under RICO] will decide to settle even a case with no merit." Accordingly, civil RICO lends itself, he argued, to the very extortive purpose "it was designed to combat." Justice Marshall cites as authority for this extraordinary proposition the Report of the Ad Hoc Civil RICO Task Force of the ABA Section of Corporations, Banking and Business Law 69 (1985). The Ad Hoc Task Force, in turn, conducted a survey of 3,200 corporate and litigation lawyers, of whom only 350 responded. Two factors, however, undermine the scientific credibility of the general results of the survey: (1) the population questioned was unrepresentative of the bar, and (2) the response rate was insufficient to warrant broad generalizations. See generally D. Huff, How to

Lie with Statistics, 11-26 (sample with built-in bias), 37-52 (sample of insufficient number) (1954). More to the point here, the survey did not ask each of the respondents a carefully phrased question calling for their opinion or experience with RICO as a settlement weapon. Instead, the opinion relied upon by Justice Marshall was volunteered by only two of the 350 respondents as grounds for repealing RICO. If fact, it is the experience of a majority of seasoned litigators in the RICO area that adding a RICO claim to a suit does not facilitate settlement; it inhibits it, particularly when a legitimate business is involved. See A Comprehensive Perspective on Civil and Criminal RICO Legislation and Litigation: A Report of the RICO Cases Committee, ABA Criminal Justice Section 121-23 (1985) (RICO Cases Report). Generally, such businesses wrongfully accused of "racketeering " will not settle suits - even those that should be compromised - as long as the racketeer label is in the litigation. Indeed, it is difficult to understand how Justice Marshall could believe that a suit with "no merit" faces a defendant with "ruinous exposure." If the plaintiff's suit has no merit, his chance of success is zero, and zero multiplied be three (or any other number) is still zero. Before this Committee accepts Justice Marshall's claim from any witness who appears before it, it ought to ask for the names of the defendants and the cases allegedly so settled. It should then inquire of the plaintiffs what their evidence was. It is doubtful that you will find that the litigation was meritless.

It is doubtful, in short, that responsible corporate or other defendants are paying off strike suits in the RICO - or any other area - at more than their settlement value, no matter what the theory of the complaint is. Neither the racketeer label nor the threat of treble damages will convince prudent managers lightly to surrender scarce resources merely because another files a suit. No matter how colorfully it is phrased, the claim that such managers act against their own interest is not credible.

If unethical attorneys have brought some frivolous suits under RICO falsely alleging fraud, they should be disciplined and, if necessary, additional remedies should be designed to deal with frivolous litigation. We should not, however, compound our injury from such frivolous litigation by denying victims of racketeering rooted in fraud their day in court under RICO. Fraud is a national problem in our society that requires stronger, not weaker, legislative efforts to curtail it.

Nor can it be persuasively argued that private RICO suits threaten unjustifiably to flood the federal courts. RICO was not discovered by the private bar until about 1979. Studies by the Department of Justice indicate, however, that less than 500 civil RICO suits were brought prior to Sedima and that 65% of them have had an independent basis for federal jurisdiction. Oversight at 127. More recently, a study of post -Sedima litigation indicates that 56% had an independent basis of federal jurisdiction. 2 Civil RICO Report No. 44 at 8 (Apr. 14,

1987). The litigation, accordingly, is not new. Even if civil RICO suits were to increase to a figure of 500 annually, and that figure were then multiplied by 10, an unlikely prospect, they would constitute less than 2% of all federal filings (5,000 out of 275,000). See generally, Annual Report of the Director of the Administrative Office of the United State Courts (1985). Indeed, it is most likely that they will eventually fall somewhere between the present antitrust (959 civil; 47 criminal) and securities and commodities (3,200 civil; 13 criminal) litigation. This would place RICO cases well below the major areas of current federal litigation: overpayments and enforcement of judgements (47,000), prisoner petitions (30,000), social security (25,000), civil rights (20,000) and labor (11,000). In fact, data from the Administrative Office indicate that in 1986, 1069 civil RICO cases were filed--not thousands--and 294 were terminated. As such, "the perceived problem of civil RICO case load is exaggerated" 2 Civil Rico Report No. 34 at 2 (Feb. 4, 1987) (remarks of Judge Pamela A. Rymer). In fact, the filings have "calmed down" and "actually present no greater problem than antitrust or complicated securities cases." Id.

A point must be made, too, about the fact of litigation. Litigation itself, as the Supreme Court recognized in Zauderer v. Office of Disciplinary Counsel of the Supreme Court of Ohio, 105 S.Ct. 2265, 2278 (1985), is not "an evil." "Over the course of centuries," the Court noted, "our society has settled upon

civil litigation as a means for redressing grievances, resolving disputes, and vindicating rights when other means fail." Id. "That our citizens have access to their civil court," the Court concluded, "is not an evil to be regretted; rather, it is an attribute of a system of justice in which we ought to take pride." The Association agrees. Accordingly, it ought to be recognized that the mere fact of RICO suits is not a matter to be decried or deplored.

The concept in RICO of a private enforcement mechanism reflects ideas found in the antitrust laws. Similarly, the RICO civil suit in the area of commercial fraud promises to serve as a like guarantee of the integrity of the marketplace. See, e.g., Alcorn County, Miss. v. U.S. Interstate Supplies, Inc., 731 F.2d 1160, 1165 (5th Cir. 1984) (scheme to defraud governmental unit) ("Congress [intended] . . . the provision for treble damages . . . to encourage private enforcement of the law on which RICO is predicated.")

Professor Edelhertz rightly observed:

In an earlier age the unlawful or ethically questionable amassing of wealth was characteristically accomplished by bald plunder or seizure of the public domain. "Teapot Dome" was a classic case, as was the land-grant device which provided the capital for building much of this Nation's railroad grid. Today such blatant power and property grabs are avoided More of us are now beneficiaries of trusts and quasi-trusts managed by the growing fiduciary industry. New targets for the crime are the increasing proportion of trusts and estates of middle class decedents, interests in union and company

pension, welfare, and profit-sharing funds, and the broad panoply of mutual funds, investment trusts, credit unions, and investment clubs. . . . As individuals we are more exposed to abuse. We are more likely to deal with strangers than with those we know (whose blemishes we can access), and we are more vulnerable than we used to be because we tend to rely more on one another or on protection by Government. Those who buy securities are better protected than ever before because of the work of the Securities and Exchange Commission and comparable state agencies, yet are more exposed to the stock fraud artist who deceives the regulatory agent or totally circumvents its supervision. . . . Caveat emptor loses meaning when we buy closed packages. . . . White collar crime is a low visibility, high impact factor in our society. Because of the changes in the nature of our economic organizations, particularly new developments in marketing, distribution, and investment, it is a fair assumption that white-collar crime has increased at a rate which exceeds population growth. Its effects intersect with and interact with other problems of our society, such as poverty and discrimination. It also weighs heavily on the aged who are, in our society, divorced from the homes and community of their children. . . . White collar crime, like common crime, can have a serious influence on the social fabric, and on the freedom of commercial and interpersonal transactions. Every stock market fraud lessens confidence in the securities market. Every commercial bribe or kickback debases the level of business competition, often forcing other suppliers to join in the practice if they are to survive. . . . The pharmaceutical company which markets a new drug based on fraudulent test results undercuts its competitors who are still marketing the properly tested drugs, and may cause them to adopt similar methods. Competitors who join in a conspiracy to freeze out their competition, or to fix prices, may gravely influence the course of our economy, in addition to harming their competitors and customers.

H. Edelhertz, The Nature, Impact, and Prosecution of White Collar Crime at 6-9 (1970).

III. The Racketeer Influenced and Corrupt

Organizations Act of 1987

The Association has carefully read the statement and accompanying materials inserted in the Congressional Record, when Congressman Conyers announced his and Congressman Edwards' intention to introduce the "Racketeer Influenced and Corrupt Organizations Act of 1987." 133 Cong. Rec. E3351 (daily ed. Aug. 7, 1987). The Racketeer Influenced and Corrupt Organizations Act of 1987 (hereafter "the 1987 RICO Act") would --

Strengthen RICO by:

1. adding new predicate offenses enacted by Congress since 1970 in the areas of violence, terrorism, and fraud,
2. assuring that marijuana offenses are a predicate offense,
3. assuring that the federal government may sue as a "person,"
4. assuring that State Attorneys General may sue as parens patriae for victims of crime,
5. providing for recovery for personal injuries (except pain and suffering) for crimes of violence,
6. assuring equitable relief for private parties,
7. providing for life imprisonment where death results from crimes of violence,

Guard Against Abuse of RICO by:

1. eliminating the "racketeer" label in fraud based suits,
2. assuring that securities fraud predicate offenses are based on "willful" conduct,
3. eliminating, where appropriate, from "pattern" single episodes (time and place),
4. excluding from RICO private suits that are primarily
 - a. domestic relations
 - b. products liability
 - c. decedents' estates, or
 - d. landlord tenant,
5. excluding "labor disputes" from RICO,
6. establishing detailed pleading rules for--
 - a. verification
 - b. particularity for

- | | |
|--|---|
| 8. assuring that the burden of proof in civil suits is a preponderance of the evidence, | i. fraud, |
| 9. providing for counsel fees for the prevailing plaintiff, | ii. coercion, |
| | iii. agency, |
| | iv. respondent superior, |
| | v. accomplice, or |
| | vi. conspiracy, |
| 10. providing for recovery of prejudgement interest, | 7. providing for notice to the Attorney General of private suits. |
| 11. assuring that actual, not treble, damages survive against a trustee in bankruptcy, and | 8. providing for treble damages for frivolous suits, |
| 12. providing for international service of process. | 9. assuring issue and claim preclusion between civil and criminal suits, |
| | 10. providing, with appropriate exceptions, voluntary arbitration of RICO disputes, and |
| | 11. providing for sense of Congress resolution for use of RICO by state and local agencies. |

The 1987 RICO Act also clarifies and resolves six issues currently in litigation:

1. An enterprise may be a defendant if it is a perpetrator,
2. No financial motive is required in violence based offenses,
3. Jurisdiction is exclusive in federal courts,
4. An association in fact enterprise must be a structured group,
5. The personal act rule is eliminated, and
6. A state of mind requirement is assured before responsibility can attach.

These amendments are in accord with the policies of the National Association of Attorneys General. They reflect an appropriately comprehensive, thoughtful and balanced effort to

achieve a careful compromise of the conflicting interests in the areas covered by RICO. As such, the Association supports the proposed 1987 RICO Act. There remain, nevertheless, several issues that the Committee may wish to consider. First, as part of the amendments to the Federal Arbitration Act (9 U.S.C. § 1 et seq), the Committee may wish to add several provisions. Generally, parties to arbitration proceedings are encouraged to cooperate in a voluntary exchange of information, but no right to discovery exists. Where an individual needs information about "racketeering activity" directed at other victims to complete his showing of a "pattern," this lack of discovery may well preclude his obtaining his RICO remedy. See, e.g., Marshall & Easley Trust Co. v. Pate, 819 F.2d 806, 809 (7th Cir. 1987) (may show acts injurious to others to establish "pattern"). To be sure, the absence of full discovery might mean that no issue or claim preclusion would be worked by the arbitration proceeding, and the party would then be free to file a subsequent RICO case in court after the arbitration proceeding had concluded.

Nevertheless, it might be preferable to authorize some system of limited discovery in the arbitration proceeding itself. See, e.g., Cal. Civ. Proc. Code § § 1282.6-1283.1 (West 1982); N.Y. Civ. Proc. § 7505 (McKenny 1980); Tex. Civ. Code Ann. § 230 (Vernon 1980). Similarly, if issue and claim preclusion exists between arbitration and subsequent judicial proceedings, the fairness and accuracy of the application of

those doctrines would be facilitated by requiring findings of fact and law. In addition, it might facilitate the willingness of arbitrators to make courageous decisions, particularly in some situations that might be imagined, to grant quasi judicial immunity.

Second, the Committee may wish to add predicate offenses to RICO from another area: hazardous waste. We recommend that the key criminal provision of the Resource Conservation and Recovery Act (4 U.S.C. § 6928), as well as comparable state legislation, be added to RICO's predicate offenses. See Appendix A.

Legitimate corporations generate hazardous waste. White-collar and organized crime elements conspire to circumvent necessary regulations for the removal, treatment or disposal of hazardous waste. See generally S2052, Corporation, Organized Crime, and the Disposal of Hazardous Waste: An Examination of the Making of a Criminogenic Regulatory Structure 24 Journal of Criminology 1 (1986), for a review of the congressional hearing and other literature. RICO should be amended to supplement the sanctions available for the control of this life-threatening problem.

IV. S. 1523

S. 1523 reflects provisions and a basic philosophy with which the Association cannot agree. First, and most important, it does nothing to strengthen RICO in such important areas as organized or white-collar crime, as well as terrorism or the conduct of other violence-prone groups. The members of the Association have a substantial body of experience with RICO,

both in criminal and civil contexts. The Association finds it difficult to believe, and terribly troubling, that those who drafted S. 1523 could not find one aspect of current law that needed to be improved from the perspective of law enforcement or the victims of crime.

Turning to the bill itself, the Association objects primarily to seven aspects of it:

- (1) The elimination of the racketeer label for all litigation.

Objection has been raised to the potentially stigmatizing effect of the term "racketeer" as it is used in civil RICO claims. The term "racketeer" currently appears in all subsections of Section 1962 and in the definitions of "racketeering activity" in Section 1961(1) and of "pattern of racketeering activity" in Section 1961(5). The statute defines "racketeering activity" in terms of the federal and state crimes that constitute its predicate offenses. These crimes include those violent and other offenses typically associated with organized crime; they also include those business offenses typically associated with white-collar crime. RICO does not distinguish between these two kinds of offenses; it provides a claim for relief for victims of "racketeering activity." All civil RICO claims, therefore, assert that the defendant engaged in "racketeering activity."

According to common usage, a "racketeer" is a person who runs "a business run by fraud or extortion." The American

Heritage Dictionary 580 (Dell ed. 1970). RICO uses the term in this generic sense, not in the pejorative sense of "gangster." The term "racketeer" is not limited to the classic organized crime figure. When Congress enacted RICO, it did not intend that RICO would apply only to the activities of organized crime figures. The statute was consciously written to apply equally to all who violated it. As such, it is appropriate for anyone who engages in racketeering activity to be labeled a "racketeer". The Association agrees with Justice White in Sedima (473 U.S. at 492): "[A] civil RICO proceeding leaves no greater stain than do a number of other civil proceedings." "Our society knows no mark of shame more stigmatizing than that of Cain, yet homicide may be both murder and wrongful death." RICO Cases Report at 100. In fact, the social opprobrium connected with the "racketeer" label is a necessary and useful aspect of the sanctions RICO imposes. "At its best, in civilized and democratic countries, punishment surely expresses the community's strong disapproval of what the criminal did. Indeed, it can be said that punishment expresses the judgement (as distinct from any emotion) of the community that what the criminal did was wrong." J. Feinberg, Doing and Deserving, 98, 100-05, 115-16 (1970). Moreover, if the social opprobrium associated with the "racketeer" label is strong, it makes RICO even more effective in deterring the offenses that are its predicates. Those who oppose the use of the term "racketeer" in

RICO in short, fail to consider the proper role of social opprobrium in the administration of justice, criminal and civil.

Despite the advantages of using the term "racketeer" in RICO, segments of the business community, in particular, complain that the "racketeer" label stings too smartly. Special pleas are now being heard in the courts and here in Congress that it is outrageous to bring "racketeering" charges against "legitimate" business people. These groups argue that it is unfair to label as "racketeers" those business people who engage in criminal conduct not usually associated with "racketeering" in the classic, gangster sense. The trouble with this argument, of course, is that it presumes that "legitimate" business people who engage in criminal fraud are lesser "racketeers" than those figures connected to organized crime -- that is, that "racketeers" wear black shirts, never white collars.

In response to the "racketeer" label objection, S. 1523 attempts to protect the reputations of business people against charges of "racketeering activity." The bill changes the name of the statute from "Racketeer Influenced and Corrupt Organizations Act" to "Pattern of Unlawful Activity Act." In addition, whenever "racketeer" or "racketeering activity" was formerly used in the statute, it replaces these terms with "unlawful" or "unlawful activity." These changes are intended to eliminate the sting of the "racketeer" label in civil RICO cases.

This proposed bill is itself overbroad. It removes the term "racketeer" from all RICO predicates, not just those dealing with business fraud. The "racketeer" label would be removed even from those predicate offenses typical of organized crime in the classic, gangster sense. The Association opposes such sweeping changes. If any change is to be made, more limited amendments should be adopted along the lines of the 1987 RICO Act, which deletes the "racketeering" label only as to business fraud.

(2) The imposition of a criminal conviction limitation

In Sedima, the U.S. Supreme court concluded, on statutory and policy grounds, that RICO does not require a criminal conviction before civil RICO remedies are available. Following the reasoning of the Supreme Court, the Association urges that a prior criminal conviction under criminal RICO or its predicate offenses ought not, in any case, to be a requirement for bringing a civil RICO claim.

RICO was, of course, modeled by its sponsors on the antitrust laws, which do not require proof of a criminal conviction to bring a civil action. Standard Sanitary Mfg. v. United States, 226 U.S. 20, 52 (1912) (a conviction requirement would "take from the statute a great deal of its power.") A prior criminal conviction requirement would unduly restrict access to the courts by private attorneys general and would, in effect, discard the "private attorney general" function under

the antitrust statutes. No valid reason exists for applying a different rule under RICO.

Such a change, some critics urge, is needed to prevent frivolous RICO suits and to keep manageable the workload of the federal judiciary. See Letter of John R. Bolton, Assistant Attorney General, Department of Justice, to Hon. Thomas P. O'Neill, Jr., Reform at 364. These two concerns have already been discussed. Neither is valid. Other substantial policy reasons exist, however, that make the prior criminal conviction limitation profoundly unwise.

First, the requirement of a prior criminal conviction in all cases, or for treble damages recovery, drastically restricts the private plaintiffs' access to the courts. This result is illustrated by considering the number of civil and criminal actions filed in federal court in the areas of antitrust and securities. As noted above, in the antitrust area, 959 civil actions are filed each year, while only 47 criminal cases are brought. Under securities and related laws, 3200 civil actions are filed each year, while only 13 criminal actions are brought. Requiring a prior criminal conviction in either of these areas would eviscerate the civil remedies available under these statutes. A similar result would occur under RICO. Indeed, that is the not-too-well-hidden purpose of those who recommend the criminal conviction limitation. It would turn RICO's promise of multiple damage relief for victims of crime

into a sham. Congress ought not be a party to that kind of legislative fraud.

Second, if this change were adopted, matters wholly unrelated to the merits of the plaintiff's RICO claim would determine who could recover, or even who could file suit for treble damages. When a prosecutor, for example, decides not to bring a RICO case, he would, therefore, completely foreclose any possibility for any RICO victim to have his day in court for treble damages under RICO. A federal prosecutor might, for example, decide to grant a defendant immunity, or permit the defendant to plead to another offense or agree to turn state's evidence. That is the course of action followed in the acceptance of Ivan Boesky's plea. The most outrageous securities defrauder in history was convicted, not of securities fraud, but conspiracy to file a false statement with the Securities and Exchange Commission. In that case, a civil plaintiff would be totally barred from recovery under RICO.

Third, and even more troubling, would be a denial of access to the court where no conviction was obtained because of a procedural flaw, not related to guilt or innocence, at the grand jury stage or at the criminal trial. It must be recognized, too, that a variety of factors, not all of which relate to guilt or innocence, influence jury verdicts. Take the fall of the Penn Square Bank in Oklahoma City, Oklahoma. The immediate effect of the failure of the \$400 million-asset bank sent shocks through the banking system. Seattle-First National Bank lost

\$100 million; it had to be saved by being purchased by Bank America Corporation. Continental Illinois Bank and Trust lost \$1 billion; it was only saved by the intervention of FDIC. The affair, brought on by massive fraud in the operation of the bank, produced many indictments, but to date no conviction of a high ranking executive. Although William G. Patterson, the head of oil-and-gas lending for the Penn Square Bank, was tried, he was acquitted on charges of wire fraud, misapplication of bank funds, and false entries in Penn Square's books. Apparently, an emotional appeal to the jury turned the day for Patterson.¹ See M. Singer Funny Money, 190-206 (1985). Jury verdicts ought to be sacred where life or liberty is at stake, but no need exists to carry that attitude over to civil litigation, in cases where verdicts are contrary to the overwhelming weight of the evidence. Such idiosyncratic jury results in criminal prosecutions, in short, ought not to prejudice the outcome of parallel civil suits.

Fourth, a prior RICO conviction requirement would also prejudice the criminal justice system as a whole. By requiring a conviction on the RICO court, a defendant's incentive to plea bargain to a non-RICO offense would be dramatically raised. By avoiding a RICO conviction, the defendant would shield himself against all civil claims, leaving the victim without RICO

¹Patterson has since been indicted on other charges related to this same fraud scheme.

recourse, as in the Boesky plea. In addition, the victim as a potential civil plaintiff would be an interested witness at the criminal trial. His testimony would be subject to sharp credibility attacks because he would have acquired an interest in the outcome. Indeed, this civil limitation would undermine the ability of the government to bring successful criminal prosecutions.

Fifth, beyond its impact on a defendant's incentive to plea bargain and the credibility of witnesses, requiring a prior criminal conviction would place unwarranted political pressure on prosecutors, since the opportunity for a RICO victim to recover would depend on the institution and success of the government's case. Prosecutors ought to be spared the reality or the appearance of such pressures.

The Supreme Court recognized the validity of these policy concerns in its Sedima decision (473 U.S. at 490 n.9). No major civil cause of action in Anglo-American jurisprudence is, in fact, now circumscribed by a prior criminal conviction requirement. See generally Note, Civil RICO: Prior Criminal Conviction and Burden of Proof, 60 Notre Dame L. Rev. 566 (1985). No valid reason exists to reject the Supreme Court's analysis and to make civil RICO the first major claim for relief in modern American jurisprudence to be so limited.

(3) The elimination of treble damages for victims

S. 1523 essentially eliminates treble damages. To be sure, it authorizes such damages where a criminal conviction has been

obtained. Those situations, however, would be so few in number that treble damages--except in criminal prosecutions in connection with plea bargaining, etc.--would play a negligible role in the enforcement of RICO. Without the precursor of a criminal conviction, recovery in suits between business entities would be reduced to actual damages. An injured natural person suing on his own behalf would be eligible for multiple damage recovery, but only under sharply limited circumstances. This double standard is even more indefensible when considered in light of the special treatment of the securities industry and small investors, noted below, and basic principles of fairness. Moreover, the proposed legislation appears to eliminate any hope of the government's ability to seek multiple damages in civil RICO actions on behalf of injured victims. Such radical surgery on RICO's basic design is profoundly unwise.

Currently, treble damage suits under RICO promise remedial relief against criminal conduct that is swift, sure, and severe, characteristics deemed essential by modern economic analysis. See generally R. Posner, Economic Analysis of Law § 7.2 (2d. ed. 1977). Professor (now Judge) Posner suggests that modern economic analysis supports private enforcement mechanisms of more than actual damages against deliberate anti-social conduct, particularly where the factor of concealment is present. Id. at 462 (private enforcement); 143, 272 (more than actual damages for deliberate conduct); 235 (concealment). If our society authorizes the recovery of only actual damages for deliberate

anti-social conduct engaged in for profit, it lets the perpetrator know that if he is caught, he need only return the misappropriated sums. If he is not caught, he may keep his ill-gotten gains, and even if he is caught and sued, he knows that he may be able to defeat part of the damage claim or at least compromise it. In short, the balance of risk under traditional simple damage recovery provides little disincentive to those who engage in such conduct. Accordingly, a number of federal statutes, particularly in the commercial area, contain treble damages provisions. See, e.g., 12 U.S.C. § 1464 (1982) (Home Owners' Loan Act of 1933); 12 U.S.C. § 1975 (1982) (Bank Holding Company Act); 12 U.S.C. § 2607 (1982) (Real Estate Settlement Act of 1974); 15 U.S.C. § 15 (1982) (Clayton Act: Antitrust); 15 U.S.C. § 72 (1982) (Revenue Act of 1916: Restraints on Import Trade); 15 U.S.C. § 1117 (1982) (Trademark Act of 1946); 15 U.S.C. § 1693f (1982) (Electronic Fund Transfer Act); 15 U.S.C. 1989 (1982) (Motor Vehicle Information and Cost Savings Act); 22 U.S.C. § 4209 (1982) (Consular Officers: Penalty for exacting excessive fees); 30 U.S.C. § 689 (1982) (Lead and Zinc Stabilization Program); 35 U.S.C. § 284 (1982) (Patents); 42 U.S.C. § 9607 (1982) (CERCLA); 45 U.S.C. § 83 (1982) (Government Aided Railroads); 46 U.S.C. § 1227 (1982) (Merchant Marine Act of 1970). Indeed, the Seventh Circuit was correct when it observed in Haroco that

"the delays, expense and uncertainties of litigation often compel plaintiffs to settle completely valid claims for a mere fraction of their value.

By adding to the settlement value of such valid claims in certain cases clearly involving criminal conduct, RICO may arguably promote more complete satisfaction of plaintiffs claim without facilitating indefensible windfalls."

747 F.2d 384, 399 n.16 (7th Cir. 1984), affirmed, 473 U.S. 606 (1985). In fact, if suits are settled at too low a figure, the deterrent impact of the damage claim will be undermined. See generally Block, Nold, and Sidak, The Deterrent Effect of Antitrust Enforcement, 89 Journal of Political Economy 429, 440 (1981) ("Neither imprisonment nor monetary penalties pose [...] a credible threat to colluding firms. ... [T]he deterrent effect ... [comes] from ... the likelihood of an award of private treble damages"). Similarly, studies of the antitrust statutes show that most antitrust suits are settled now at close to actual damages. Ironically, it may be necessary to authorize treble damages to assure that deserving victims receive actual damages in the RICO area.

The idea of treble damages for certain kinds of unlawful commercial practices has deep roots. It had its origins in the Statute Against Monopolies, [1624] 21 James I, c. 3, Section 4, which authorized treble damages for those injured by unlawful monopolies. Rightly, Parliament recognized that it was "one thing to pass statutes and ... quite another then to insure that [they were] actually enforced." IV W. Holdsworth, A History of English Law at 355 (3rd ed. 1945). Accordingly, "it was a common expedient [in the Middle Ages and beyond] to give the public at large an interest in seeing that a statute was

enforced" Id. Going back to Roman Law, we see the idea of multiple damages for various kinds of wrongs as a characteristic feature. The "delict" of theft ran back at least to the Twelve Tables (450 B.C.). "[T]he penalty ... [was] four times the value of the thing stolen" when the offender was caught in the act; otherwise, it was "double." A. Watson, The Law of the Ancient Romans at 76 (1970). Extortion was remedied by four times the loss. Id. at 80. Possession of stolen property was remedied by three times the value of the property. Id. at 77.

Much of what the Supreme Court has said about the antitrust laws may be said of the RICO private civil suit concept. RICO creates "a private enforcement mechanism that ... deter[s] violators ... and ... provide[s] ample compensation to ... victims." Blue Shield of Virginia v. McCready, 457 U.S. 465, 472 (1982). Such "private ... litigation is one of the surest weapons for effective enforcement." Leh v. General Petroleum Corp., 382 U.S. 54, 59 (1965). A private "treble-damage remedy [is needed] ... precisely for the purpose of encouraging private challenges to violations." Reiter v. Sonotone Corp., 442 U.S. 330, 344 (1979) (emphasis in original). Such suits "provide a significant supplement to the limited sources available to the" government. Id. Such damages (1) compensate victims for all accumulative harm, (2) encourage private citizens to bring RICO actions, and (3) deter future violators. Note, Treble Damages under RICO; Characterizations and Computation, 61 Notre Dame L. Rev. 526, 533-34 (1986).

Substantial differences exist, however, between treble and punitive damages. Unlike punitive damages, treble damage awards are mandatory, not discretionary. Compare Edwards v. Travelers Insurance of Hartford, 563 F.2d 105, 118 (6th Cir. 1977) (Tenn. law mandatory); Locklin v. Day-Glo Color Corp., 429 F.2d 873, 878 (7th Cir. 1970) (anti-trust mandatory) and McMahon Food Co. v. Call, 406 N.E.2d 1206 (Ind. App. 1980) (Ind. Code § 34-4-30-1 treble damages for theft mandatory), with Travelers Indemnity Co. v. Armstrong, 442 N.E.2d 349, 362 (Ind. 1982) (award of punitive damages discretionary with jury). Treble damages awards relate to the damage done to the victim, not to the conduct or wealth of the defendant. See, e.g., Smith v. Milikin, 247 Ga. 369, 371-72, 276 S.E.2d 35, 27-38 (1981) (purpose of exemplary damage award regulates amount; for compensation, it must bear relation to injury; for deterrence, it must be sufficient to deter future acts); Shahrokhfar v. State Farm Mutual Automobile Insurance Co., 634 P.2d 653, 658-59 (Mont. 1981) (punitive damages may not be reduced by comparative negligence, since their purpose is to punish, not compensate). Indeed, actual damages may not always be a prerequisite to an award of punitive damages. Anderson v. United Finance Co., 666 F.2d 1274, 1278 (9th Cir. 1982) (Equal Credit Opportunity Act). Treble damages claims may also survive the death of the perpetrator, while punitive claims usually do not. Compare State Farm Fire and Casualty Co. v. Estate of Caton, 540 F.Supp. 673, 683-85 (N.D. Ind. 1982) (RICO claim survives death of

perpetrator; danger to lives of "fronts" was a factor in the decision), with Thompson v. Estate of Petroff, 319 N.W.2d 400, 408 (Minn. 1982) (punitive damage claim does not survive death of perpetrator). It may be appropriate in certain instances to award both treble and punitive damages. See e.g., Banderas v. Banco Central del Ecuador, 461 So.2d 265 (Fla. Dist. Ct. App. 1985) (award of treble and punitive damages upheld in foreign exchange fraud under Fla. RICO).

The characteristics of treble damages make them superior to punitive damages in fulfilling RICO's basic purpose: sanctioning sophisticated forms of crime. Making damages discretionary lessens their deterrent impact. Putting the defendant's characteristics in issue runs the risk of jury prejudice. Since punitive damages do not survive the death of the perpetrator, their authorization may even put the lives of organized crime connected "fronts" in danger when such "fronts" are sued under RICO. The move away from treble damages is staunchly opposed.

(4) The raising of the burden of proof for victims in private actions

S. 1523 also would raise the burden of proof for private litigants before a multiple damage recovery could be awarded. The narrowing of the right of recovery under the statute is opposed. RICO was, of course, modeled on antitrust statutes, which only require proof by a preponderance of the evidence before the treble damages are awarded. Ramsey v. UMW, 401 U.S.

302, 307-11 (1971). There is no valid reason for imposing a higher burden of proof under RICO. Indeed, the majority of the state RICO statutes that explicitly deal with the issue set the standard at a preponderance. See generally Note, Civil RICO: Prior Criminal Conviction and Burden of Proof, 60 Notre Dame L. Rev. 566 (1985). When the purpose of a statute is penal and life and liberty interests are at stake, the proof required for the government to prevail must be beyond a reasonable doubt. When the interests in issue are primarily pecuniary, a higher standard is not demanded, and the risk of error should be shared equally by the parties. Other federal statutes, such as the fraud provisions of the securities acts, similarly require only a preponderance of the evidence as the burden of proof. Herman & MacLean v. Huddleston, 103 S.Ct. 683, 691 (1983).

A major factor in enactment of the federal securities statutes was, in fact, a desire by Congress to correct deficiencies in the common law limitations on fraud actions developed in the 19th Century. The Supreme Court in Herman & MacLean considered the applicable standard of proof in a private action under the Securities Exchange Act of 1934. Mindful that common law fraud under 19th century jurisprudence, with its emphasis on a philosophy of laissez faire, required a "clear and convincing" standard, the Court, nevertheless, labeled reference to common law practices "misleading . . . since the historical considerations underlying the imposition of a higher standard of proof (has) questionable pertinence here." Id. The Court found

the preponderance of the evidence standard applicable in a Section 10(b)(5) case. The standard, the Court found, "allows both parties to 'share the risk of error in roughly equal fashion.' (cite omitted). Any other standard expresses a preference for one side's interests." 103 S.Ct. at 692. Despite the "risk of opprobrium that may result from a finding of fraudulent conduct," which the defendant faced, the Court chose not to express a preference for either side. Nor should this Committee. Between an alleged "RICO perpetrator" and an alleged "RICO victim," how can Congress put its thumb on the scales of justice in favor of the perpetrator?

(5) The special treatment for the securities industry and small investors

S. 1523 accords the securities industry an unjustifiable special status. Nothing that has happened on Wall Street in recent memory warrants such special treatment. The special treatment is the product of the interaction of several provisions, that must be carefully read in light of present law to be understood. Generally, securities fraud is excluded from the bill. To be sure, an "exclusion from the exclusion" is provided for insider-trading and small investors, but it is much too narrow to achieve its stated purpose.

Apart from suits by a governmental agency for governmental injury or after criminal conviction, S. 1523 severely limits the routes of civil recovery for victims of crime once the required "pattern of unlawful activity" has been established. First, the

bill provides for the recovery of "actual damages to [any] person [whose] property or business [is injured] by reason of" a RICO violation, including securities fraud. This provision thus reduces current treble damages recovery to actual damages in all areas.

Second, an injured natural person may recover double punitive damages along with his actual damages under certain, limited circumstances--basically consumer activity. By limiting double damages recoveries to "natural persons," this provision will have its primary adverse impact on victimized businesses, but it will also directly affect the investment activities of mutual funds, welfare funds, universities, churches, and other not-for-profit institutions. Each of these institutions are artificial entities, but they represent people. Nevertheless, they will be denied any access to punitive multiple damages recoveries. The stock market is currently a \$2.5 trillion industry. In 1983 and 1984, 60.6 million shares of stocks, excluding over-the-counter trading, were sold on the registered exchange. Stock market fraud, of course, has its greatest impact on individual investors, who can ill-afford to lose life savings. Today, however, they make up only 50% of the market, compared to 83% in 1975. Mutual funds, on the other hand, have increased from 361 in 1978 to 1,352 in 1984. The value of mutual fund assets in 1984 was \$370.6 billion. Pension funds, too, have mushroomed from \$578 billion in 1970 to more than \$1.5 trillion today. Together, the

holdings of all institutions--pension funds, mutual funds, insurance companies, banks, brokers, and dealers--now add up to a third of all corporate stock, up 25% from 1977. Yet S. 1523 would deprive these assets of even punitive double damages protection under RICO against securities and other forms of fraud. This result is indefensible.

But there is still another catch, specially designed to relieve the securities industry of RICO liability for its fraudulent activity. If "State [or] Federal securities laws make available an express or implied remedy for the type of behavior on which the claim of the plaintiff is based" only actual damages may be obtained (emphasis added). If securities laws cover the "type of behavior," a plaintiff may not recover even double punitive damages; he will be limited to actual damages. How can this sort of special interest legislation for one industry be justified?

The phrase "type of behavior" is a loop-hole of major proportions for the securities industry. Its size, however, is a matter of dispute. The legislative history of similar legislation (H.R. 5445), which passed in the House, but failed to pass in the Senate last year, contains conflicting statements on the meaning of this "securities law exclusion." Clearly, if state or federal securities law provides a civil remedy, a plaintiff could not recover punitive damages; he would be limited to actual damages. Nevertheless, a sharp conflict exists on whether the coverage by the securities acts of the

"type of behavior"--regardless of whether the plaintiff has a remedy, or standing to sue under the securities acts--prevents the plaintiff from recovering his or her punitive damages. See, e.g., Blue Chips Stamps v. Manor Drug Stores, Inc., 421 U.S. 723 (1975) (standing limited to "purchaser-sellers"). If the coverage by the statutes of the "type of behavior," but without providing a private civil remedy, prevents a plaintiff from recovering punitive damages, then many of the victims of aggravated securities fraud, particularly insider trading, as now practiced on Wall Street, will be unjustifiably denied a RICO civil remedy. In a number of the situations involving insider trading now occurring on Wall Street, those connected to target companies will not have standing to sue those who fraudulently steal and trade on inside information taken from acquiring companies, even though a crime involving securities fraud will have been committed that injured them. See, e.g., compare Dirks v. SEC, 463 U.S. 646 (1983) (party connected to acquiring company had no duty to target company for securities fraud) with United States v. Newman, 664 F.2d 12 (2nd Cir. 1981), cert. denied, 464 U.S. 863 (1983) (party connected to acquiring company can be guilty of criminal misappropriation of inside information). In fact, many victims of the most notorious insider trading scams of modern times--those perpetrated by Dennis Levine, Ivan Boesky and Martin Siegel--have an uncertain basis of civil recovery under the current Federal securities law because of their status as defrauded

shareholders of target corporations. Clearly, fraudulent traders are receiving an unwarranted safe harbor of protection under this proposed legislation.

Congressman Boucher's statement in support of H.R. 5445 in the 99th Congress indicated that it is the "type of behavior," rather than the presence of a remedy in a federal securities laws that is crucial. If the behavior is generally within the statute, his bill would have prevented the plaintiff from recovering punitive damages. "As long as a case is based on behavior that falls within the reach of securities law regulation, a plaintiff may no use civil RICO to seek punitive damages." (132 Cong. Rec. E3533 (daily ed. Oct. 10 1986)).

Although Senator Metzenbaum interpreted H.R. 5445 last year to allow victims of securities fraud to sue under Civil RICO for punitive damages in situations where the private plaintiff merely did not have standing to sue under the securities laws, stating that, "The scope of suits for which punitive damages are available should be interpreted liberally in favor of the plaintiff" (132 Cong. Rec. S16698 (daily ed. Oct. 16, . 1986)), this interpretation is by no means controlling.

Neither does S. 1523's "exclusion" for insider trading violations adequately protect investors. The scope of the exception for insider trading is considerably less than it might appear to be. "Consumers," of course, are limited to natural persons. The businesses, which are injured in most insider trading schemes, are excluded. So, too, are all of the

institutions through which consumers participate in the market--mutual funds, welfare and pension funds, etc. In addition, the insider trading "exclusion" from the securities law "exception" to the multiple damages liability provisions of S. 1523 is framed in terms of the current securities statutes. As such, the insider trading "exclusion" is so worded that it excludes--and therefore makes liable for multiple damages--only those primarily liable, the immediate insider himself. Those who would otherwise be secondarily liable--aiders and abettors, principals or employers, or controlling persons--that is, those who usually have a deep pocket, and those who might be able to make effective the victim's claim for relief, are immune from multiple damage relief for insider trading.

Likewise, the small investor "exclusion" from the securities law "exception" is of dubious significance. While it is laudatory to protect small investors, the protections and remedies afforded to small investors by S. 1523 are illusory. The bill protects small investors only in their individual capacity. As discussed above, most small investors invest not in their individual capacity but, rather, through mutual funds and institutions. Yet, the small investor remedies of S. 1523 do not extend to the small investors' investments in such funds or institutions. In addition, the definition of "security" under S. 1523 excludes securities which do not comply with the requirements of the Securities and Exchange Act of 1934, for

example, unregistered securities. This creates a disparity of protection for even small investors--those who invested in registered securities in compliance with the Securities and Exchange Act are afforded lesser remedies than their counterparts who invested in non-complying securities. Moreover, providing protection only to small investors excludes any offer of equal protection to larger scale investors who are equally at risk. This sort of special interest legislation is wholly unacceptable and is vigorously opposed.

(6) The imposition of an unduly short statute of limitations on victims

S. 1523 would impose on private Civil RICO suits a three year statute of limitations. This period fails to make crucial distinctions between the types of litigation that will be brought under civil RICO; it also is unjustifiably short.

Currently, RICO does not include a statute of limitations. The Supreme Court has held that private litigation under RICO is to be governed by the four year period of analogous provisions of the antitrust statute. Agency Holding Corp. v. Mally Duff & Associates, Inc., 107 S.Ct. 2759, 2767 (1987) (Clayton Act, 15 U.S.C. § 15(b)). Four years is also the standard period for other federal treble damage actions. See e.g., Home Owners Loan Act, 12 U.S.C. 1464(9)(3); Bank Holding Company Act, 12 U.S.C. 1977. In addition, fifteen of the 27 states that have enacted state RICO statutes have provided for special periods. See

exhibit C. Eleven set it at five years; one at six; three at seven. None set it as low as three.

Statutes of limitations serve a number of important public policy interests, but most importantly, they insure that stale claims are not litigated. See generally, United States v. Marion, 404 U.S. 307, 322 n.14 (1971). Nevertheless, the proposed three year period of S. 1523, when read in light of its other provisions and RICO itself, does not serve the public interest. Rather, it serves only the special interests of defendants, particularly those involved in fraud litigation. First, victims of fraud--almost by definition--often will be unaware of the fraud when it actually occurs. Indeed, the most successful fraud is one of which the victim never becomes aware. Currently, Federal law recognizes this fact by providing that the period of limitations does not begin to run until the victim knows or "should have known" he was injured and by whom he was injured. See, e.g., Hunt v. Am. Bank & Trust Co. of Baton Rouge, LA., 783 F.2d 1011, 1014-15 n.4 (11th Cir. 1986). Since the standard is objective ("should have known"), not subjective ("actually knew"), it always included an element of uncertainty. It, therefore, puts pressure on plaintiff's counsel, who may not be brought into the picture until well after the conduct constituting the fraud occurred, to file as soon as possible--or at least not to cut it too close. In addition, RICO requires the showing of a "pattern" of unlawful activity. This means that the victim may well have to

investigate more than his own victimization. See, e.g., Marshall & Ilsley Trust Co. v. Pate, 819 F.2d 806, 809 (7th Cir. 1987). Indeed, it is the systematic pattern of unlawful activity, impacting on multiple victims, that most clearly falls within the ultimate rationale of RICO. The indefinite scope of the "pattern" concept thus introduces another element of uncertainty into RICO litigation. Properly, S. 1523 also codifies aspects of current law that requires pleading "with particularity" for multiparty liability. Rule 9(b); Slotnick v. Garfinkle, 632 F.2d 163, 165 (1st Cir. 1980). But--unjustifiably--S. 1523 goes beyond current law and extends these requirements to all of the elements of RICO. Meeting this requirement will necessitate still greater pre-filing investigation and will put pressure on plaintiff's counsel to postpone filing as long as possible, but not so long as to risk filing too late. Finally, S. 1523 provides that "frivolous, unreasonable or groundless" claims "shall" result in an award of attorney's fees to the defendant. These standards will, of course, always be applied in retrospect, even if they are, as a matter of law, to be viewed from the point in time at which the plaintiff's counsel filed suit or continued it after certain facts or legal developments had become known. In sum, a statute of limitations as short as three years, coupled with these additional and extraordinary new burdens and sanctions, will unjustifiably place victims of crime and their counsel in a Catch 22 situation. What justifies this hostility to victims of

crime? These provisions go well beyond curtailing stale claims. Their impact will unjustifiably be to curtail all claims. Indeed, it is difficult to read these provisions and conclude that their anti-victim bias was other than intended. Accordingly, these provisions are adamantly opposed.

One further point: it is now widely and appropriately recognized in federal law that governmental entities are typically given special statutes of limitations. See, e.g., 28 U.S.C. §§ 2415, 2416 (except as otherwise provided by federal law, suit by United States or agency for contract (express or implied) six years from accrual; for tort three years from accrual (including discovery), except six years for diversion of money paid under grant or conversion of property); Insider Trading Sanction Act (15 U.S.C. § 78(u)(D) (five year ban on SEC action for treble damages); Jankowitz v. United States, 533 F.2d 538, 547 (Ct. of Cl. 1976) (kickback on bribes suits on contract implied in law; six years); FDIC v. Roldan Fomsea, 795 F.2d 1102, 1106-10 (1st Cir. 1986) (except as otherwise provided by federal law, general federal period applied to FDIC suit brought in corporate capacity); accord FDIC v. Peterson, 770 F.2d 141, 143 (10th Cir. 1985). Sadly, governmental entities are not always as responsive as private institutions. As such, to all of the difficulties noted above, we must add the inevitable delay factor necessarily associated with the institutional decision-making processes of the government. Nevertheless, to the degree that such delay reflects, as it often does, the

inherent conservatism of collective decisions by a governmental bureaucracy, it, of course, generally works to the advantage of possible defendants by inhibiting the bringing of marginal suits. No one suggests, for example, that government entities have abused civil RICO under current law. Nevertheless, the time period under S. 1523 for federal actions for fraud will be cut by half--from six years to three. Similar state and local actions will be reduced from four years to three. These results cannot be justified. To the degree that governmental entities, federal or state, will be faced with such unduly short deadlines in the future, it will mean that cases simply will not be instituted. S. 1523 would inhibit more than stale claims. Its tragic impact will be to curtail all claims--stale or otherwise. Accordingly, the Association recommends an increase of the period of limitations to at least five years to reflect the complexity of pre-filing investigations and pleading requirements. Alternatively, the Association recommends setting a different and higher period of limitation for governmental entities and the types of actions brought by them. Any other approach would be an indefensible rewriting of current law to reflect, not the interests of victims of crime, but the interests of its perpetrators. Such profoundly unwise legislation is vigorously opposed.

(7) The adoption of retroactive rules

S. 1523 includes provisions that impose its new rules on old suits. In general, if a person could collect only actual

damages under the new statute, he would be able to collect only actual damages under the old statute--even though his suit had been instituted under the old statute and would otherwise have been governed by present law. While Congress has broad power to make civil, rather than criminal legislation, retroactive, the retroactivity provisions of S. 1523 are profoundly unwise. Americans do not play cards where one party only can get the benefit of an unannounced rule (duces wild) on the last hand. Indeed, people once were shot for trying surreptitiously to implement such procedures. It may not be unconstitutional, but it is unAmerican. Congress should not legislate in that fashion. These provisions are a none-too-subtle effort by special interest groups to win issues in a legislative forum that they have lost in a judicial forum. Indeed, they raise serious questions about the integrity of any member of Congress who accepts a campaign contribution from these groups and then votes in favor of this legislation. Such questionable legislation is emphatically opposed.

V. Conclusion

The Association concludes its testimony, as it began, by expressing its firm support for all efforts to clarify or strengthen RICO and by expressing its firm opposition to any effort to curtail or weaken it, particularly in the fraud area.

Specifically, the Association supports RICO reform that would--

1. preserve RICO's effectiveness criminally as a prosecutive weapon against sophisticated forms of organized or white-collar crime as well as terrorism or other violence-prone groups.
2. preserve RICO's effectiveness civilly as a weapon against fraud that may be used by federal, state and local units of government, and
3. preserve RICO's effectiveness civilly as a weapon against fraud that may be used by other similar victims of crime.

At the same time, the Association opposes any effort to circumscribe RICO in these vital areas, and supports responsible efforts to strengthen the statute and curtail demonstrated abuse of civil RICO by irresponsible private litigants.

THE NATIONAL ASSOCIATION OF ATTORNEYS' GENERAL HAS SUBMITTED A GREAT DEAL OF INFORMATION IN THE FORM OF EXHIBITS TO THEIR TESTIMONY. THE EXHIBITS CAN BE VIEWED IN THE ANTITRUST, MONOPOLIES AND BUSINESS RIGHTS SUBCOMMITTEE OFFICE.

Senator METZENBAUM. Mr. Feigin.

Mr. FEIGIN. Mr. Chairman, Senator DeConcini, thank you for inviting me here today. My name is Philip A. Feigin. I am the Assistant Securities Commissioner for the Colorado Division of Securities. I testify before you today on behalf of the North American Securities Administrators Association, or NASAA, a non-profit organization whose members include the securities regulators of the 50 States, and we are devoted to the principles of investor and consumer protection.

Senator Metzenbaum, we must first acknowledge that your record as an advocate of the little guy, the consumer, and the less fortunate in our society is exemplary. You are a champion of the public good and we are better as a nation for your service.

Nonetheless, be it in the spirit of compromise or not, we must speak in opposition to Senate bill S. 1523, a bill to amend private civil RICO. The bill would change the word "racketeering" to "unlawful" and, frankly, I fear that means changing "RICO" to "weak-o."

In the brief time allotted to me, I will touch on two main points of the bill, the natural person requirement and the securities law remedy exclusion. S. 1523 would allow only natural persons to seek punitive damages for securities law fraud violations.

In your July 22 statement introducing the bill, you stated, in part, that,

It is not appropriate for Congress to preclude plaintiffs from recovering more than actual damages for securities fraud when they are among the most vulnerable and unsophisticated investors who have been the victims of extremely outrageous conduct.

Unfortunately, the natural person requirement precludes just such recovery. Institutional investors like mutual funds, pension funds, and trusts comprise half of the stock market. Small investors invest in mutual funds because they do not wish to dabble in the market for their own, but choose the diversity, experience, resources, and relative security of such funds.

Billions of retirement dollars are managed in pension funds which, in turn, invest in the marketplace. Multiple damages remedies are essential to deter criminal conduct. Under S. 1523, these funds could not bring multiple-damage cases if victimized by someone engaged in a pattern of indictable securities mail or wire fraud.

We must allow these holders of public funds to protect their investors by providing punitive damages or treble damage suits against securities regulators. The natural person requirement must be rejected. Who better to protect the investing consumer than such institutions, using treble damages?

I might also add that Professor Goldsmith will touch on the natural person issue in more depth in later testimony.

Second, the securities law exclusion would preclude punitive damages for RICO violations if securities law claims could be brought unless the plaintiff was an insider trading victim or a small investor, as defined. I will briefly summarize three criticisms.

First, why let off the securities industry? The events of the last 2 or 3 years in the financial world have hardly given rise to the

belief that regulation and enforcement should be relaxed. If anything, they must be tightened.

If patterns of criminal securities mail and wire fraud are to be effectively deterred, we must have plaintiffs out there with the ability and power to sue for treble damages. We cannot afford to eliminate the proven remedy of treble damages for any victims of securities racketeering.

Second, the bill would allow natural person insider trading victims to sue for punitive damages. While I do not profess to be an expert in this most complex area, I do know that it is in extreme flux at the moment.

Important theories of liability under both securities and mail fraud theories are before the Supreme Court and the decisions to be rendered may significantly alter the manner in which we deal with insider trading.

S. 1523 has perhaps moved too fast. Considering the events of the last few weeks and the dramatic effect the Supreme Court may have on the subject, this is not the time to fiddle with insider trading in RICO. Remember, S. 1523 would be retroactive. An adverse Supreme Court ruling, coupled with the passage of S. 1523, could have sweeping impact.

Can we risk letting off the likes of Messrs. Boesky, Levine, Segal and those to follow? And I might add that Mr. Boesky was not indicted or convicted of a predicate RICO offense, to my understanding.

Thirdly, the bill would allow small investors to seek punitive damages under RICO. Small investors generally would be those below the median portfolio's household income range.

Senator METZENBAUM. Can you wind up?

Mr. FEIGIN. Yes. In response to a simple question, I would suggest that the accredited investor standards of Regulation D in the securities law be used for small investor if small investor must be there.

In summary, white-collar crime is a growth industry. This is no time to backtrack. We must have a potent RICO treble damages securities fraud remedy for everyone.

Thank you.

[Statement follows:]



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STATEMENT OF

PHILIP A. FEIGIN
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on behalf of
NORTH AMERICAN SECURITIES ADMINISTRATORS ASSOCIATION

before the

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

Concerning S. 1523
and
THE ISSUE OF PRIVATE CIVIL RICO

October 29, 1987

Mr. Chairman, Members of the Committee, I thank you for affording me the opportunity to come before you today to give testimony on behalf of the North American Securities Administrators Association, Inc. ("NASAA") concerning Senate Bill 1523 and the issue of private rights of action under Title 18, U.S.C. section 1961 et seq., the Racketeer Influenced and Corrupt Organization Act ("RICO").

NASAA is a non-profit organization composed of the securities regulatory agencies of the fifty states, the District of Columbia, the Canadian provinces, the Republic of Mexico and Puerto Rico. NASAA is devoted to the protection of investors from fraud and abuse in the marketplace. It is with this important goal in mind that on July 20, 1985, the NASAA Board of Directors adopted the following resolution:

Be it resolved that the Board of Directors of the North American Securities Administrators Association, Inc. ("NASAA") fully supports the concept of private rights of action under the federal Racketeer Influenced and Corrupt Organizations Act ("RICO") involving securities, mail and wire fraud, and therefore strongly supports both retention of federal securities, mail and wire fraud violations as predicate offenses, and retention of treble damages for private civil actions under RICO. The Board of Directors is aware that claims of abuse of private civil RICO in the securities, mail and wire fraud area have been voiced. NASAA supports Congressional examination of these claims, inquiry into areas of potential abuse, and consideration of limited statutory modifications to RICO to reduce the potential for such abuse if indeed they exist. However, it is paramount that the essential concept of private civil RICO

remedies as now in place in the context of securities, mail and wire fraud be retained and not undermined.

We come before you today to voice concerns about S. 1523 because we believe its enactment would fundamentally undermine private civil RICO in the areas of securities, mail and wire fraud to the grave detriment of the investing public.

I have been involved in the investigation and prosecution of state securities law violations for almost nine years, both in Wisconsin and Colorado. I have been actively involved in NASAA for most of that time, participating in the development of its members' enforcement initiatives, policies and programs. I have been a member of the Advisory Committee on Commodity Futures Trading Commission-State Cooperation for over two years, and have served as a member of the State Regulation of Securities Committee of the American Bar Association for several years.

In my almost nine years of state securities law enforcement experience, white collar crime has grown from a major problem to a national catastrophe. National scandals involving check-kiting, money laundering, defense contractor fraud, insider trading, commodities fraud and market manipulation have significantly eroded the public faith in our markets, industries and financial institutions, and raised fundamental questions about our commercial ethics as a nation.

Our financial markets have experienced explosive growth in the last ten years. From 1981 to 1985, the volume of shares traded on the New York Stock Exchange tripled. The events of the last few weeks have dwarfed even that figure. During the same five year period, over-the-counter trading increased 500%.

During that same period, staffing at the Securities and Exchange Commission ("SEC") actually dropped (2177 in 1977 to 1930 in 1986). Meanwhile, consumer complaints to the SEC increased 72% from 18,500 in 1980 to more than 31,000 in 1985, and complaints to the National Association of Securities Dealers ("NASD") rose from 1017 in 1980 to 3922 in 1986.

It is in the context of this crisis of faith and ethics that members of the financial community have called on the Congress to emasculate RICO in its private civil application to patterns of indictable acts of securities, mail and wire fraud. Banking, accounting, securities and other industry groups have raised numerous issues during the RICO debate concerning alleged abuses of the law by private plaintiffs, asserting the adequacy of traditional federal and state remedies for such frauds, the purported overbreadth of RICO, and more. Professor G. Robert Blakey, O'Neill Professor of Law at Notre Dame Law School, the drafter of RICO, and its most ardent champion and advocate has addressed the broad spectrum of these allegations in his numerous appearances before Congressional committees and subcommittees and in various national

publications, including two National Law Journal articles, "Civil RICO," August 3 and 10, 1987. We endorse and embrace heartily Professor Blakey's arguments in support of RICO and his responses to industry assaults thereon.

We wish to focus today on some of the specific proposals for amendment to RICO made in S. 1523:

1. "racketeering" to "unlawful";
2. treble damages to actual damages with punitive damages of up to twice the actual damages in limited cases;
3. the "natural person" limitation;
4. the securities law exclusion; and
5. the small investor exception.

I. "Racketeering" to "Unlawful"

Private civil RICO currently provides a treble damages remedy to a private plaintiff who succeeds in establishing by a preponderance of the evidence that a defendant operated an enterprise in a manner constituting a pattern of indictable securities, mail or wire fraud (as well as other offenses) to his injury. These predicate offenses comprise the definition of "racketeering activity," 18 U.S.C. section 1961.

RICO was designed to provide a meaningful deterrent to those who would otherwise engage in patterns of indictable white collar fraud. Among the deterrent factors are enhanced criminal sanctions, civil injunctions, seizure and discovery, and at the private civil level, treble damages. There is also the significant deterrence of being labeled as a "racketeer."

To abandon this label, for both traditional organized criminal elements as well as pattern white collar offenders, would be to weaken RICO's deterrent value.

It has been argued by its detractors that certain private plaintiffs have used the prospect of RICO allegations in an extortionate manner, preying on the target's fear of being labeled a "racketeer" in pleadings, to obtain settlements which otherwise would not have been obtained. In fact, the assertion of a RICO claim has been shown to inhibit, not foster, settlement. See A Comprehensive Perspective on Civil and Criminal RICO's Legislation and Litigation: ABA Criminal Justice Section 121-23 (1985).

In the broad perspective of the RICO debate, the change from "racketeering" to "unlawful" is not the most crucial issue. In fact, is it not likely that even if the change is made, the "RICO" acronym will remain in common usage for years afterward?

II. Treble Damages to Actual and Punitive Damages

Modeled after the anti-trust laws, private civil RICO is designed to recruit "private attorneys general" through the treble damages remedy in an effort to deter proscribed conduct. A RICO plaintiff is guaranteed treble damages should he prevail.

S. 1523 would make such a recovery far less likely. After trial on the merits for actual damages, additional evidence on punitive damages would be heard and at least eight factors considered by the court before an award of up to twice the actual damages might be made.

Therefore, treble recovery would become discretionary, not mandatory. The incentive to bring such actions would be proportionately reduced. We would have fewer private attorneys general willing to bring actions. While the potential for punitive damages recovery is certainly more desirable than only actual damages, it cannot be disputed that mandatory treble damages provides not only a greater attraction for private plaintiffs but also a greater deterrent for those who would engage in the conduct prescribed. Studies of anti-trust statutes have revealed that settlements in private civil anti-trust suits are generally made at close to actual damages levels due to the potential for treble damages recoveries at trial. Punitive damages awards are rare in most areas of the law and even rarer in the white collar arena. RICO conduct would not be as effectively deterred under the punitive damages proposal.

III. The "Natural Person" Limitation

Under proposed section 1964(c)(2)(B)(II)(aa), the proposed punitive damages relief would be available only to "natural persons." Mutual funds, money market funds, unit investment trusts, pension plans, non-profit organizations, insurance companies, banks, savings institutions, brokerage firms and other corporations would all be precluded from seeking punitive damages from those who victimized them by engaging in a pattern of indictable securities, mail or wire fraud. This proposal flies in the face of the intent of RICO, is unsupportable and unconscionable.

Only 50% of the participants in the nation's stock markets today are private individual investors, compared to 83% in 1975. The institutional participants in the market have grown proportionately. The number of mutual funds increased from 361 in 1978 to 1352 in 1984, and there are many more today. Pension funds have doubled in total assets since 1970, to more than \$1.5 trillion. These institutional investors and others own approximately one third of all corporate stock.

Private investors rely on these institutional investors for their training, skill, experience, diversification and management. The institutions represent a relatively secure place to put their money. Smaller investors unwilling to dabble in the market on their own buy mutual funds instead. By

precluding such funds from seeking punitive damages under RICO, small investors are harmed. It is the institutional investor who has the expertise, resources and responsibility to pursue the RICO perpetrator on behalf of its investors.

The proposed bill would leave the actual damages remedy in place for such institutional investors, but as stated in American National Bank & Trust Co. of Chicago v. Haroco, Inc., 747 F.2d 384, 399 n.16 (7th Cir. 1984), affirmed, 473, U.S. 606 (1985),

... the delays, expense and uncertainties of litigation often compel plaintiffs to settle completely valid claims for a mere fraction of their value. By adding to the settlement value of such valid claims in certain cases already involving criminal conduct, RICO may arguably promote more complete satisfaction of plaintiffs claim without facilitating indefensible windfalls.

Therefore, vast pools of investor funds would be left without private civil RICO's effective protections.

By denying the institutions the punitive damages remedy, their investors are denied the remedy as well. The assets of a mutual fund are its own, not those of the investors. Under the law, it is the fund which is victimized, not its investors, although the losses may be passed on to them nonetheless. The investors, the natural persons, lack standing to sue the racketeer because they were not injured in their business or property.

In the course of the RICO debate, many of the law's detractors have argued that RICO was intended solely to combat the infiltration of legitimate businesses by "Organized Crime." We do not agree with that narrow construction, but even if arguendo this was the sole intent, even these detractors must agree that the natural person requirement is wholly contrary to the intent of RICO. Legitimate businesses would be denied the unique RICO remedy of treble (or punitive) damages, (even if infiltrated by traditional "Organized Criminal" elements!) if their victimization took the form of securities, mail or wire fraud. Pension funds victimized by churning, banks victimized by fraudulent checking practices, corporations victimized by fiduciaries who misappropriated inside information, would all be without the RICO treble (or punitive) damages remedy.

How can this fundamental retreat be justified? Certainly, the number of private civil RICO actions would be materially reduced, but at what cost? What policy consideration can be formulated to substantiate the change? If an individual invests \$15,000 in a series of fraudulent oil ventures, he may seek punitive damages under S. 1523. But, if that individual invests instead, for reasons of safety and security, in an oil and gas mutual fund which in turn invests in those same ventures, punitive damages are unavailable. Where is the rationale?

RICO is intended to deter those who would engage in concerted, patterned, premeditated, criminal conduct. It stands to reason that the best means of achieving the goals of RICO are to make certain that those most able to pursue its remedies be afforded the opportunity. Institutional participants in the financial marketplace must not be denied the treble (or punitive) damages remedies of RICO for securities, mail or wire fraud.

IV. The Securities Law Exclusion

Even if a natural person investor was injured by reason of a pattern of indictable securities, mail or wire fraud, he would be barred from seeking punitive damages under section 1964 as proposed if either state or federal securities law provides "an express or implied remedy for the type of behavior" on which the claim is based. It was likely the intention of the drafters of this provision to preclude those suing under securities laws from bootstrapping themselves into the treble damages provisions of RICO. However, many problems are presented by the proposed language.

The first concerns issues of standing. In commenting on the proposal as contained in H.R. 5445 in 1986, Congressman Boucher stated his belief that if behavior was generally within that proscribed by securities laws, punitive damages could not

be sought. However, Senator Metzenbaum interpreted the provision to allow punitive damage suits under RICO, even if the type of behavior involved was covered by securities laws, as long as the plaintiff lacked standing to sue under those laws. This basic issue must be resolved conclusively.

In addition, there may be bizarre results. Let us assume that a RICO plaintiff is suing the promoters of a precious gems scam for punitive damages on the theory that the promoters engaged in a pattern of indictable mail fraud. If these promoters can succeed in arguing that their scam involved the offer and sale of securities, the punitive damages claim would be precluded because the defendants will have established that the plaintiff had a claim under securities laws. Similarly, RICO defendants could evade punitive damages claims by asserting and prevailing on claims that plaintiffs had standing to sue under securities laws. These would be perverse twists on the norm, wherein the absence of securities jurisdiction and standing are common defense arguments in investment and securities litigation.

Under even Senator Metzenbaum's broader interpretation, the victim of a pattern of indictable securities fraud would have no greater recourse against a RICO defendant than he would have against him for selling an unregistered security, a strict liability offense. This is not deterrence.

This exclusion, if adopted, would be a concession to the securities industry of monumental proportions. Has Wall Street earned such a concession in the last few years? Clearly not. In fact, resource restrictions at the state and federal levels argue in favor of broader private remedies, not the opposite, and this is certainly so in the securities field. So often we regulators hear from industry that self-regulation is most efficient and desirable. Let the market regulate itself. Private civil actions are part and parcel of that self-regulation. Recidivist, pattern, premeditated, racketeers are an undeniable part of that marketplace. They must be deterred with every available weapon, including treble damages under RICO.

V. The Small Investor Exception

S. 1523 would also allow a "small investor" to pursue punitive damages in a securities case. The term "small investor" is defined as a person who owns securities which, at the time the cause of action arose, had a value of less than or equal to the median portfolio value of all United States securities holders of such securities, or, a person whose household income is less than or equal to the median U.S. household income.

To the extent that we favor the availability of treble or punitive damages to all victims of patterns of indictable securities, mail or wire fraud, we certainly endorse and support this exception. However, we believe it far too limited, misleading, misguided and unjustified.

In developing its Regulation D, the SEC developed the concept of "accredited investor," a person who does not require the protection of federal securities registration because of his presumed level of sophistication and resources to make decisions of his own. At Rule 501(a), the SEC, in part, defines such an accredited investor to include...

(5) Any person who purchases at least \$150,000 of the securities being offered, where the purchaser's total purchase price does not exceed 20 percent of the purchaser's net worth at the time of sale, or joint net worth with that person's spouse, for one or any combination of the following: (i) cash, (ii) securities for which market quotations are readily available, (iii) an unconditional obligation to pay cash for securities for which market quotations are readily available which obligation is to be discharged within five years of the sale of the securities to the purchaser, or (iv) the cancellation of any indebtedness owed by the issuer to the purchaser;

(6) Any natural person whose individual net worth, or joint net worth with that person's spouse, at the time of his purchase exceeds \$1,000,000; [and]

(7) Any natural person who had an individual income in excess of \$200,000 in each of the two most recent years and who reasonably expects an income in excess of \$200,000 in the current year....

It should be obvious that the SEC chose a somewhat higher standard for this determination than the drafters did for the small investor under S. 1523. The SEC has made a determination as to which investors can allegedly "take care of themselves." This threshold must be viewed as more appropriate than those proposed by S. 1523, if such a concept is to be implemented at all.

It is ironic that the very persons S. 1523 would allow to seek punitive damages are those least able to pursue such relief. A small investor is likely to make a small investment. The complexities of RICO and securities litigation are likely to discourage a \$5,000 investor from acting even if the prospect is a \$15,000 recovery. Legal representation would be difficult to find and prohibitively costly.

The policy is all wrong. Private civil RICO is meant to deter pattern conduct. Government cannot prosecute or enjoin even most of it. The treble damages provision was intended to recruit private help. By eliminating all but natural persons, and then anyone with a portfolio or household income above median levels from the ranks of those who may avail themselves of the punitive damages remedy, S. 1523 turns away those most likely and capable of providing that much needed deterrence. Should not those vulnerable to suffering the greatest loss to

financial racketeers have the most weapons at their disposal? By analogy, would the anti-trust laws work if private civil treble damages actions could only be brought by firms with either less than \$100,000 in assets or less than ten employees?

CONCLUSION

The proposals contained in S. 1523 would cripple RICO in the white collar crime arena, with little basis in public policy. We would simply be giving the financial industry a wholly unwarranted break.

White collar crime in this nation is a crisis. It threatens to engulf us. We must finally recognize that a person who engages in a pattern of indictable securities, mail or wire fraud is a real crook. Our system continues to convict and imprison 19 year old kids who steal \$300 from a McDonald's with a rubber knife, while 50 year old crooked arbitrageurs who make off with millions, pay it back (or most of it) when caught (if caught) and never see the inside of a cell.

Yes, there have been some RICO abuses. In fact, governmental agencies have been sued under RICO too. We have also been sued under section 1983 for civil rights violations, liens have been placed on our homes by extremists claiming unconstitutional abuses of authority, and more. This does not mean we should do away with

the Civil Rights Act, or with RICO. Strengthen the abusive filing provisions. Do not gut the Act. We have heard so often from the regulated industry that we should not regulate in the prophylactic sense; we should strengthen enforcement for violative conduct. The same can be said for RICO. Let plaintiffs sue for treble damages. Enhance the remedies for abusive suits. Do not throw the baby out with the bath water.

Who can recall when the stock market has so dominated the news and our everyday lives? Is there any question that our markets, financial institutions and professionals are suffering a major crisis of confidence and public trust? The public, the man on the street, would indeed be amazed and incredulous if he were to learn that the Congress planned to drastically limit the sanctions which could be brought against financial criminals by private citizens and companies. This is no time to retreat.

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Senator METZENBAUM. Thank you very much, gentlemen. I do not have any questions. Do you, Senator DeConcini?

Senator DECONCINI. Mr. Chairman, I will be short due to the time constraints here. I do have two questions of Mr. Holmes.

Mr. Holmes, number one, your brother wants to know if you are going to buy dinner tonight. [Laughter.]

Mr. HOLMES. Yes, sir.

Senator DECONCINI. Good. You are off to a good start with this committee.

Senator METZENBAUM. Not on the State's expense account.

Senator DECONCINI. No, of course not.

Mr. HOLMES. I realize that. If you knew my State's expense account, you would know there is no difference. [Laughter.]

Senator DECONCINI. Mr. Holmes, I am interested in how you would reform RICO so that suits brought under it for competitive advantages are limited, and by this I do not mean frivolous suits with no merit.

I understand your testimony to offer several remedies for this kind of abuse, and what I am talking about is suits that are not clearly meritless, but that, because of the threat of attorney's fees and treble damages, may, and very possibly do, have a real coercive effect on business.

What can we do to keep businesses from using RICO against each other for purposes unrelated to what Congress has in mind?

Mr. HOLMES. Senator DeConcini, Chairman Metzenbaum, I would have to say that the National Association has not studied that issue in the light in which you place it, although that would certainly be a reform of RICO that I believe that the RICO practitioners in the State attorneys general offices across the country would support.

And I would offer to take that question back to the National Association and give it our studied attention.

Senator DECONCINI. That would be helpful, and if you want to supply that for the record, I am sure the Chairman would be glad to include it.

Mr. Feigin or Mr. Weld, do you have any comments on that?

Mr. FEIGIN. Just briefly, I think in the antitrust area we are seeing that the existence of treble damages has led to the result that generally settlements approximate actual damages levels.

Secondly, I think the ABA's own study indicated that, in fact, the coercive effect is just the opposite; that people who are charged under RICO in civil actions are less likely to settle rather than the risk perception that they will be called a racketeer. So I am not sure that what seem to be the surface truths are, in fact, realities.

Senator DECONCINI. Mr. Weld?

Mr. WELD. If the question is how to keep businesses from abusing civil RICO, I suppose this bill is one possible approach which represents a compromise. Another possible solution, if you are not going to have a bill like this or anything else, is rely on the courts to cut out the excesses, which we have been doing.

Senator DECONCINI. Thank you.

Mr. Chairman, I have no further questions.

Senator METZENBAUM. Thank you. Thank you very much, gentlemen.

Our next panel will be Anthony di Buono, Senior Vice President, General Counsel, and Secretary of Colt Industries, on behalf of the NAM; B.Z. Lee, senior partner of Seidman and Seidman, on behalf of the American Institute of Certified Public Accountants, of Houston, accompanied by Philip Lacovara; and David Hyman, General Counsel of Bear, Stearns & Co., on behalf of the Securities Industry Association, New York, NY, accompanied by Donald J. Crawford.

Gentlemen, I guess I started off with Mr. di Buono, so we will hear from you first.

STATEMENT OF A PANEL CONSISTING OF ANTHONY J. DI BUONO, SENIOR VICE PRESIDENT, GENERAL COUNSEL, AND SECRETARY, COLT INDUSTRIES, INC., ON BEHALF OF THE NATIONAL ASSOCIATION OF MANUFACTURERS, NEW YORK, NY; BERNARD Z. LEE, SENIOR PARTNER, SEIDMAN AND SEIDMAN, ON BEHALF OF THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, HOUSTON, TX, ACCOMPANIED BY PHILIP A. LA-COVARA, COUNSEL; AND M. DAVID HYMAN, MANAGING DIRECTOR, BEAR, STEARNS AND COMPANY, ON BEHALF OF THE SECURITIES INDUSTRY ASSOCIATION, NEW YORK, NY, ACCOMPANIED BY DONALD J. CRAWFORD

Mr. DI BUONO. Mr. Chairman, I am Anthony di Buono, senior vice president, general counsel, and secretary of Colt Industries, and I am testifying on behalf of the National Association of Manufacturers.

NAM appreciates the opportunity to appear before the committee today, and strongly urges the reform of the federal civil RICO statute to eliminate the current litigation abuses resulting from this over-broad statute.

NAM vigorously supports the introduction of S. 1523. The modifications provided by the legislation fairly address the primary excesses now occurring against legitimate businesses and will focus the extraordinary remedies of civil RICO on intended organized criminal activity.

Senator METZENBAUM. Can you bring the mike a little closer, please?

Mr. DI BUONO. I am sorry.

Because the existing language of RICO is so broad, particularly in its inclusion of mail and wire fraud, almost anybody that becomes involved in a commercial dispute is also likely to be a litigant in a civil RICO suit.

Many contract disputes, for example, routinely include allegations of civil fraud. If a plaintiff merely includes an allegation that either the mails or the telephone were used more than once in the process of either drawing up or breaching the contract, the simple contract dispute is transformed into a federal RICO under the Organized Crime Control Act. Moreover, under the provisions of the statute, an unsuccessful defendant will pay treble damages and attorney's fees and be labeled a racketeer.

The explosion of the number of reported decisions on RICO are only the tip of the iceberg. It should be noted that the vast majority of RICO suits do not go to trial. The substantive threat of being labeled a racketeer and of being exposed to treble damages puts

enormous pressures on defendants to settle even meritless RICO suits.

A 1968 NAM study found that most of the RICO suits in which the surveyed companies were involved concerned ordinary commercial disputes, product liability actions, or environmental problems, although they extended to patent infringement and sexual harassment suits as well.

The current use of civil RICO in private actions also has a devastating effect not only on the individuals and companies who are named as defendants, but also on a significant body of common and statutory law. Through the RICO device, plaintiffs are able to federalize lawsuits which ordinarily would be handled in State courts interpreting State statutory and common law.

S. 1523 would preserve and focus the extraordinary remedies of civil RICO against organized crime. Treble damages would be retained where the plaintiff is the Federal Government, a State government, or a unit of local government, or in those instances where the injury is egregious, and treble damages would also be retained against a defendant who has been criminally convicted of a RICO predicate act.

Of primary importance to the manufacturing community is the provision eliminating treble damages in ordinary business-against-business suits. Reducing liability to actual damages in such commercial cases would reduce the incentive of private plaintiffs to arbitrarily attach RICO claims to business disputes.

Punitive damages would be provided under the current bill in egregious cases. NAM supports the provisions requiring that the plaintiff must prove by clear and convincing evidence that the defendant acted in conscious and wanton disregard of the consequences of the defendant's actions to the plaintiff.

We support the requirement that the trier of fact shall consider the extent to which an award of actual damages in class actions fulfills the deterrent function of punitive damages. We also support the provision requiring that evidence relating to the amount of punitive damages be introduced only after a finding of actual damages.

Senator METZENBAUM. Can you wind up, please?

Mr. DI BUONO. The reforms contained are ones which go a long way to curbing the egregious uses which have resulted from the overly broad language of the statute, and the NAM looks forward to working with the committee to pass S. 1523 and thus bring fairness and balance to this law.

Thank you.

Senator METZENBAUM. Thank you, Mr. di Buono.

[Statement follows:]

MANUFACTURING ≡ CREATES ≡ AMERICA'S STRENGTH

Testimony
on

**FEDERAL CIVIL RICO REFORM
S. 1523**

by
Anthony J. di Buono
Senior Vice President, General Counsel
and Secretary
Colt Industries Inc.

On behalf of
the National Association of Manufacturers

Before the Committee on the Judiciary
United States Senate

October 29, 1987



National Association of Manufacturers
1331 Pennsylvania Avenue, NW, Suite 1500 — North Lobby
Washington, DC 20004-1703 (202) 637-3000

EXECUTIVE SUMMARY

The National Association of Manufacturers vigorously supports S. 1523. The modifications provided by this legislation fairly address the primary excesses now occurring against legitimate businesses and will focus the extraordinary remedies of civil RICO on intended organized crime activity.

While Congress attempted to forge a weapon against organized crime, the statutory language of RICO is so broad that its primary use today has grown far beyond what Congress intended. Since 1980, RICO has been discovered by an increasing number of creative and aggressive plaintiffs' attorneys as providing an irresistible windfall for their clients. It has been transformed into a frightening weapon employed in ordinary business disputes.

In 1986, a survey of 120 companies conducted by NAM found that prior to 1984, only 12 civil RICO suits had been filed, but from 1984 to 1986, 152 RICO suits had been filed against those same companies. A 1985 study by the American Bar Association of the use of civil RICO confirmed the enormous growth in RICO suits.

S. 1523 preserves the goals of civil RICO while eliminating current abuses. Treble damages would be retained by the federal government as well as state and local units of government. Treble damages would also be retained against a defendant who has been criminally convicted of a RICO predicate act.

Of primary importance to the business community is the provision eliminating treble damages in ordinary business-against-business suits. Reducing liability to actual damages in such commercial cases would reduce the incentive of private plaintiffs to arbitrarily attach RICO claims to business disputes.

NAM considers the effective date provision both equitable and necessary to resolve pending RICO abuses. We consider the punitive damage provision fairly drafted.

NAM also strongly supports the following provisions:

- o allowing attorneys' fees against any party for frivolous claims;
- o allowing an affirmative defense for conduct of defendants undertaken in good faith reliance on state regulatory action;
- o requiring that in a plaintiff's claim, the facts against each defendant be averred with particularity;
- o changing of the statutory term "racketeering" to "unlawful activity";
- o requiring a three-year statute of limitations for RICO claims.

NAM looks forward to working with the committee to pass S. 1523 and thus bring fairness and balance to this law.

TESTIMONY OF THE NATIONAL ASSOCIATION OF MANUFACTURERS

ON S. 1523

BEFORE THE SENATE COMMITTEE ON THE JUDICIARY

OCTOBER 29, 1987

Mr. Chairman, members of the committee, I am Anthony J. di Buono, senior vice president, general counsel and secretary, Colt Industries, New York, New York. I am testifying this morning on behalf of the National Association of Manufacturers (NAM).

NAM appreciates the opportunity to appear before the committee today and strongly urges the reform of the federal civil RICO statute to eliminate the current litigation abuses resulting from this overly broad statute. NAM vigorously supports the introduction of S. 1523. The modifications provided by the legislation fairly address the primary excesses now occurring against legitimate businesses and will focus the extraordinary remedies of civil RICO on intended organized crime activity.

I. THE PRIMARY USE OF CIVIL RICO TODAY HAS GROWN FAR BEYOND WHAT CONGRESS INTENDED.

In 1970, Congress enacted the Organized Crime Control Act. (Pub. L. 91-452). This legislation was a comprehensive response to an extensive series of investigations and congressional committee hearings into the problems of organized criminal activity in the

United States. The statute established a wide range of new provisions in the criminal code such as special grand juries, protection programs for government witnesses and dangerous special offender sentencing procedures in order to provide the federal government with the tools it needed to confront the special problems of organized crime. In enacting these new provisions, the Congress specifically declared that,

It is the purpose of this Act to seek the eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime. 84 Stat. 922, 923.

Title IX of the Organized Crime Control Act addressed the specific problems of "racketeer influenced and corrupt organizations" (RICO). This section was designed as a weapon against a particularly egregious practice of criminal syndicates: the infiltration by organized crime into legitimate businesses. This practice had been recognized as a serious problem from the very start of congressional investigations into organized crime. As the Kefauver Committee noted in 1951, "One of the most perplexing problems in the field of organized crime is presented by the fact that criminals and racketeers are using the profits of

organized crime to buy up and operate legitimate business enterprises." (S. Rep. No. 141, p. 33, 82nd Cong., 1st Sess.)

In order to accomplish this goal, Title IX prohibited engaging in a "pattern of racketeering activity," defined in the statute to include violations of a wide variety of state and federal criminal offenses known as "predicate offenses." The predicate offenses include bribery, counterfeiting, extortion and obstruction of securities laws, as well as other criminal statutes. A person is deemed to have engaged in such a pattern under the statute if he or she engages in "at least two acts of racketeering activity" in a 10-year period.

The Organized Crime Control Act was first considered and passed by the Senate. As passed by the Senate, the criminal penalties and civil powers of injunctive relief found in Title IX were to be enforced solely by the government. At that point in the legislative process, private citizens or businesses had not been given the right to sue under the RICO provisions of the Organized Crime Control Act. When the legislation was subsequently considered by the House Judiciary Committee, however, an amendment was adopted to Title IX providing for a private right of action similar to that found in antitrust statutes; i.e. the award of treble damages and attorneys' fees to successful plaintiffs. The addition of the private right of action under Title IX was undertaken with very little discussion or consideration of the practical consequences of simply inserting such a right in the RICO language adopted by the Senate. As the U.S. Court of Appeals for

the Second Circuit has noted in reviewing the origins of private RICO suits,

The addition was not considered an important one, a remarkable fact which in itself indicates that Congress did not intend the section to have the extraordinary impact claimed for it. Indeed, when the [House] Judiciary Committee initially introduced the amended bill, it did not even announce to the House that it had made the addition. Sedima, S.P.R.L. v. Imrex Co., 741 F.2d 482 (2d Cir. 1984) reversed on other grounds, 473 U.S. 479 (1985).

The Second Circuit, along with many other courts which have studied the legislative history of RICO, concluded that Congress was not aware of the possible enormous implications of the RICO private right of action it adopted in 1970. While Congress may have intended to forge a weapon to use against organized crime, the statutory language of RICO is so broad that its primary use today has grown far beyond what Congress intended.

II. THE ABUSES OF RICO

For 10 years after its enactment, the RICO provisions, as well as the other parts of the Organized Crime Control Act, fulfilled their intended purpose and provided the federal government with the resources needed to begin to successfully attack and control

organized crime. Not surprisingly, because private citizens ordinarily do not file civil suits against criminal syndicates, the hastily enacted RICO private right of action was seldom used. Since 1980, however, the private RICO provision has been discovered by an increasing number of creative and aggressive plaintiffs' attorneys as providing an irresistible windfall for their clients. Simply put, the broad, expansive language of the RICO statute allows it to be employed in many commercial disputes. Thus, despite the language found in the Senate Committee Report, as well as the statement of purpose contained in the statute itself, declaring that RICO was designed to be a significant weapon against organized crime, it has been transformed into a frightening weapon employed in ordinary business disputes.

Because the language of RICO is so broad, particularly in its inclusion of mail and wire fraud, and violations of the securities laws, almost any party that becomes involved in a commercial dispute is also likely to be a litigant in a civil RICO suit. Many contract disputes, for example, routinely include allegations of fraud. If a plaintiff merely includes an allegation that either the mails or the telephone were used more than once in the process of either drawing up or breaching the contract, the simple contract dispute is transformed into a federal RICO suit under the Organized Crime Control Act. Moreover, under the provisions of the statute, an unsuccessful defendant will pay treble damages and attorneys' fees, and be labeled a racketeer.

While U.S. government attorneys have various restraints placed on their use of RICO by the Justice Department, private plaintiffs'

attorneys do not operate under such restraints and have aggressively employed RICO in ever-increasing numbers and varieties of situations. In 1986, a survey of 120 companies conducted by the National Association of Manufacturers found that prior to 1984 only 12 such suits had ever been filed, but from 1984 to May of 1986, 152 civil RICO suits had been filed against those companies. A 1985 study by the American Bar Association of the use of civil RICO confirmed the enormous growth in RICO suits. The ABA study found only nine reported RICO decisions prior to 1980. By 1984, there were approximately 270 RICO decisions, 76 percent reported in 1983 and 1984.

Moreover, despite this explosion in the number of reported decisions, these suits are only the tip of the iceberg. It should be noted that the vast majority of RICO suits do not go to trial. The substantive threat of being labeled a racketeer and of being exposed to treble damages puts enormous pressures on defendants to settle even meritless RICO suits. As Justice Marshall has written,

Many a prudent defendant, facing ruinous exposure, will decide to settle even a case with no merit. It is thus not surprising that civil RICO has been used for extortive purposes, giving rise to the very evils that it was designed to combat. Sedima, S.P.R.L. v. Imrex Co., 473 U.S. at 506 (Marshall, J., dissenting).

As noted above, RICO suits are continually appearing in more fields of the law, ranging ever further away from the statute's

intended purpose as a weapon against organized crime. RICO suits have begun to appear in divorce cases, attorney-client conflicts, landlord-tenant controversies, disputes concerning franchise bids, controversies among church members, and probate and inheritance matters. The NAM study found that most of the suits in which the surveyed companies were involved concerned ordinary commercial disputes, product liability actions or environmental problems, although they also extended to patent infringement and sexual harassment suits. The ABA report states that 40 percent of the 270 cases concerned allegations of securities fraud and an additional 37 percent alleged common law fraud in a commercial setting. Only 9 percent of the reported RICO cases concern the type of actual criminal activity, such as arson or extortion, generally associated with organized crime. Another study conducted by the American Institute of Certified Public Accountants found,

Civil RICO is used almost exclusively in commercial disputes. The statute is now being invoked in every kind of litigation where the predicate offense of fraud can possibly be alleged. Virtually all of these claims are either covered by specific federal regulatory laws such as securities laws or do not belong in the federal courts at all. In the vast majority of cases, civil RICO claims are being used as weapons against the very people Congress was seeking to protect: legitimate business people. AICPA White Paper on Civil RICO
Oct. 10, 1984.

The inclusion of a RICO cause of action has become such a matter of routine in current litigation that Judge Shadur of the Northern District of Illinois has written, "Would any self-respecting plaintiff's lawyer omit a RICO charge these days?" Papagrannis v. Pontikis, 108 F.R.D. 177 at 179 (N.D. Ill. 1985). As the NAM study indicates, our members have not escaped the ever-growing and ever-widening use of RICO in ordinary business disputes. For example, in Century Graphics Corporation v. Harris Graphics Corporation, C.A. No. 86-5375 (E.D. Louisiana 1987) the defendant corporation was sued under RICO on the grounds that the corporation had misrepresented the speed at which two printing presses which the plaintiff had purchased from them would operate. Surely such ordinary disputes do not call for treble damages, attorney's fees and labels of racketeers.

The current use of private civil RICO suits also has a devastating effect, not only on the individuals and companies who are named as defendants, but also on a significant body of common and statutory law. Through the RICO device, plaintiffs are able to federalize lawsuits which would ordinarily be handled in state courts interpreting state statutory and common law. In addition, RICO suits based on violations of federal securities laws are creating an entirely new body of securities requirements which, as Justice Marshall has written, has the effect of "virtually eliminat[ing] decades of legislative and judicial development of private civil remedies under the federal securities laws". Sedima, S.P.R.L. v. Imrex Co., 473 U.S. at 505 (Marshall, J., dissenting).

As the explosion of RICO suits grew in the early and mid-1980s, various federal district and circuit courts sought to control the abuse by strictly reading the broad language of the statute in light of the far more restricted congressional intent expressed in the legislative history of RICO. These decisions attempted to restrain the use of RICO to its intended purposes by reading requirements into the statute, for example, that a defendant should have been criminally convicted of a RICO offense before a private civil suit would arise, or that the defendant had a long association with active organized criminal groups.

In 1985, however, the Supreme Court concluded that despite what was obvious in the legislative history of the statute, the broad language of the statute itself allowed the expansive use of RICO to which plaintiff lawyers were so aggressively and frequently turning. In reaching this decision, the Court noted that repairing this abuse must be undertaken by the Congress and not by the courts.

It is true that private civil actions under the statute are being brought almost solely against such defendants [legitimate businesses], rather than against the archetypal, intimidating mobster. Yet this defect - if defect it is - is inherent in the statute as written, and its correction must lie with Congress. Sedima, S.P.R.L. v. Imrex Co., 473 U.S. at 499.

III. S. 1523 PRESERVES THE GOALS OF CIVIL RICO WHILE
ELIMINATING CURRENT ABUSES.

S. 1523 would preserve and focus the extraordinary remedies of civil RICO against organized crime. Treble damages would be retained where the plaintiff is the federal government, a state government, or a unit of general local government in those instances where there is injury to the governmental body's business or property. Treble damages would also be retained against a defendant who has been criminally convicted of a RICO predicate act.

Major litigation excesses would be eliminated by S. 1523. Of primary importance to the manufacturing community is the provision eliminating treble damages in ordinary business-against-business suits. Reducing liability to actual damages in such commercial cases would reduce the incentive of private plaintiffs to arbitrarily attach RICO claims to business disputes.

Punitive damages would be provided in egregious cases. NAM believes this new remedy is fairly drafted. NAM supports the provision requiring that the plaintiff must prove by clear and convincing evidence that the defendant acted in conscious and wanton disregard of the consequences of the defendant's actions to the plaintiff. We support the requirement that the trier of fact shall consider the extent to which an award of actual damages in class actions fulfills the deterrent function of punitive damages. We also support the provision requiring that evidence relating to

the amount of punitive damages may be introduced only after a finding of liability for actual damages (unless the court is persuaded otherwise).

NAM considers the effective date provision of S. 1523 both equitable and necessary to resolve pending RICO abuses. We vigorously support the requirement that the actual damage recovery in purely commercial litigation apply to pending cases unless "the court determines that, in light of all the circumstances" limiting the plaintiff's recovery to actual damages instead of treble damages "would be clearly unjust." NAM also supports the language clarifying and limiting civil RICO liability to damage or harm to a plaintiff's business or property.

NAM also strongly supports the following provisions of S. 1523:

- o allowing attorneys' fees against any party for frivolous claims;
- o allowing an affirmative defense for conduct of defendant undertaken in good faith reliance on state regulatory action;
- o requiring that in a plaintiff's claim, the facts against each defendant be averred with particularity;
- o changing of the statutory term "racketeering" to "unlawful activity";
- o requiring a three-year statute of limitations for RICO claims.

IV. CONCLUSION

The reforms contained in S. 1523 will go a long way toward curbing the egregious uses which have resulted from the overly broad language of the statute. It is time to place reasonable controls on civil RICO so the legal remedies it provides do not continue to be worse than the problems it seeks to address. The extraordinary remedies of civil RICO should be reserved for the extraordinary problems of organized crime and particularly egregious activities contemplated by S. 1523, and not for ordinary commercial and business disputes.

NAM looks forward to working with the committee to pass S. 1523 and thus bring fairness and balance to this law.

November 17, 1987

Responses By Anthony J. di Buono
To Questions By
Senator Strom Thurmond
On RICO Reform

Question 1: Summarize how S. 1523 will affect pending cases? Is NAM satisfied with the impact S. 1523 will have on pending cases?

Response: The NAM is satisfied with the impact which S. 1523 will have on pending cases in business-to-business disputes. S. 1523 will give the federal courts flexibility to limit the application of the reform legislation in those cases where a remedy of actual damages "would clearly be unjust." In no instance with respect to all existing pending civil RICO cases would a plaintiff's remedy be vitiated. The salutary effect of this provision would be to enable courts to dismiss an inappropriate treble damage claim in a purely commercial dispute and substitute for it a claim for compensatory damages, the traditional remedy in commercial litigation.

The NAM's 1986 civil RICO survey showed an alarming increase in civil RICO suits against manufacturers arising from ordinary business disputes. These suits have not been brought in the spirit of Civil RICO as Congress intended, but via a statutory loophole under-overly broad statutory language. The application of S. 1523 to pending suits -- not in an across-the-board manner, but in a case-by-case manner -- will favorably address this ongoing abuse in an appropriate fashion by allowing the courts to fashion the appropriate civil remedy.

Question 2: A tort victim must have an appropriate legal remedy. However, there has been no evidence brought forward that state courts have failed to provide such a remedy. By permitting lawsuits for recovery of punitive damages, doesn't S. 1523 unnecessarily federalize broad areas of state common law and state statutory causes of action?

Response: The NAM withdrew support of the House-passed RICO reform legislation in the 99th Congress because of overly-broad punitive damage language. The NAM continues to believe that maintaining the integrity of the state and federal laws is very important.

S. 1523 satisfies our concern of overly-broad punitive damage language. This bill reduces the impact on state and federal laws by increasing the burden of proof standard and evidentiary standard surrounding punitive damage recovery. For punitive damages to be recovered under S. 1523, the plaintiff must convince the trier of fact by "clear and convincing" evidence that the defendant acted in "conscious and wanton disregard of the consequences of the defendant's actions to the plaintiff." This is a higher evidentiary standard than currently exists in a majority of jurisdictions for awarding punitive damages.

In addition, this legislation addresses the possible abuse of punitive damages in class actions. S. 1523 requires the trier of fact to consider the extent to which "the class action aspect of the compensatory damage award fulfills the deterrent function of punitive damages." We also strongly support the provision in S. 1523 which bifurcates evidence relating to liability under civil RICO and evidence relevant only to the amount of punitive damages.

Such provisions significantly curtail the federalization of state common law and federal statutory law by limiting the punitive damage provision to only the most egregious situations. These

are necessary and very sound modifications to last year's bill.

Question 3: Earlier legislation proposed that one way to eliminate RICO abuse was to require that one of the predicate acts be an offense other than mail or wire fraud. What is your view on this alternative?

Response: Although the NAM was fully supportive of previous legislative efforts to reform civil RICO by mandating in the statute that one additional predicate act other than mail or wire fraud be required for a finding of a pattern of racketeering activity -- referred to as the "fraud plus" alternative -- the NAM is convinced that pursuing the "fraud plus" alternative is not an appropriate legislative strategy at this time. The compromise legislation which has been worked out, embodied presently in S. 1523 (except for the widespread disagreement over the "small investor" provision) represents the best solution for solving the current abuses of civil RICO. The NAM would not support any effort to amend S. 1523 to include a "fraud plus" provision.

Senator METZENBAUM. Mr. B.Z. Lee, senior partner, Seidman and Seidman, on behalf of the American Institute of Certified Public Accountants. Mr. Lee, may I ask you, is that the same Seidman and Seidman who was the head of the FDIC? He used to be with an accounting firm.

Mr. LEE. He was my predecessor as the managing partner of the firm.

Senator METZENBAUM. Were you not formerly located in Michigan?

Mr. LEE. Grand Rapids, MI, yes, sir.

Senator METZENBAUM. But now you are in—oh, the accountants are in Houston, TX.

Mr. LEE. My firm has offices in 40-odd cities of the United States and the American Institute of CPAs is headquartered in New York City.

Senator METZENBAUM. I see, OK.

Mr. Chairman, I am Bernard Lee, senior partner of Seidman and Seidman, testifying on behalf of the American Institute of Certified Public Accountants, of which I am a past chairman of the board. Accompanying me today is the AICPA special counsel, Philip A. Lacovara, of the law firm of Hughes, Hubbard & Reed.

I have summarized our statement, a copy of which we offer for the record.

Senator METZENBAUM. It will appear in the record.

Mr. LEE. Given your special interest in our views, Mr. Chairman, I ask your indulgence if I should exceed by slightly the 5 minutes that you—

Senator METZENBAUM. I am going to have trouble doing that.

Mr. LEE. All right, sir.

Senator METZENBAUM. Once I do that for you, I must do it for everybody.

Mr. LEE. I would not ask if it were not for the special interest that you have expressed in our views.

The American Institute is the national association of CPA's in the United States. We are 250,000 members in public practice, industry, education, and government, and the Institute is widely recognized as the authoritative voice of the accounting profession.

More than two years ago, we first appeared before this Committee in search of relief for the onerous civil provisions of the RICO statute, and I will not repeat all of the things that we said at that time. I would like to offer for the record a copy of the statement that we did make at that point in time.

Senator METZENBAUM. It will be accepted.

[The following was received for the record:]

STATEMENT OF
RAY J. GROVES, CHAIRMAN
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Before the

Committee on the Judiciary
of the
United States Senate

July 31, 1985

Mr. Chairman, Members of the Committee, I am Ray J. Groves, Chairman of the American Institute of Certified Public Accountants. Accompanying me are Philip B. Chenok, President of the Institute, Theodore C. Barreaux, the AICPA Vice President in charge of our Washington office, and AICPA Special Counsel Philip A. Lacovara of Hughes Hubbard & Reed.

The AICPA is the national professional organization of certified public accountants (CPAs) in the United States. Its service to the profession and to the public spans almost one hundred years. Today, membership consists of over 230,000 CPAs in public practice, in industry, in education and in government. The Institute is widely recognized as the authoritative voice of the accounting profession.

Mr. Chairman, as you noted in a recent speech, Congress from time to time encounters a need to reexamine a statute to ensure that it is being implemented according to Congressional intent. You went on to note that the private civil RICO provisions have been interpreted and applied in ways which necessitate further Congressional scrutiny. Speaking through the Vice President's Task Group on Financial Services, the Reagan Administration has recognized that the civil RICO statute is being abused and needs to be reformed. Attorney General Meese, in response to a question posed at hearings before this Committee in April, stated that the Justice Department had been analyzing the use of this statute by private parties and "may be coming before the Congress with some legislation to modify the statute."

The need to reexamine civil RICO has gained greater urgency just in the last month, when the United States Supreme Court ruled that the courts do not have the power to cure the abuse of civil RICO by private parties by narrowly interpreting its open-ended language. The Court unanimously agreed that civil RICO had come to be used in a manner not envisioned by Congress, but a bare majority of the Court held that whatever defect in the language of RICO leads to this misuse is, as the majority opinion put it, "inherent in the statute as written, and its correction must lie with Congress."

We commend this Committee for undertaking this significant review of the civil RICO provisions. We can think of no case which so perfectly fits your standard for revisiting a statute to determine if its use conforms with Congressional intent.

At the outset, the AICPA would like to state clearly and without equivocation that we are not in favor of weakening the criminal sanctions directed against organized crime as contained in the Organized Crime Control Act of 1970 or as it was amended in 1984. To the contrary, we would enthusiastically support enhanced sanctions against such insidious activities. Moreover, we fully support properly constructed civil remedies against organized crime, including the application of civil RICO provisions. But the AICPA does call for Congressional action to redirect the RICO statute to its intended purpose of attacking organized crime.

The bill from which the Organized Crime Control Act of 1970 (including the RICO title) was derived originated in the Senate and contained no private civil RICO provision when introduced or when initially passed by the Senate. The object of the legislation was to enhance the federal government's arsenal in the war against organized crime, not to create new remedies for commercial disputes. This Committee's Report on the bill clearly stated the bill's precise purposes:

"The eradication of organized crime in the United States by strengthening the legal tools in the evidence gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime."

S. Rep. No. 617, 91st Cong., 1st Sess. 2 (1969).

In this vein, Senator McClellan, the chief sponsor, focused his arguments for the bill on the activities of "La Cosa Nostra." In particular, he was concerned that when "organized crime moves into a business, it usually brings to that venture all the techniques of violence and intimidation which is used in its illegal business." 115 Cong. Rec. 5872 (1969). There was concern, however, that any attempt to define "organized crime" per se in the statute -- as Senator McClellan had attempted to do in earlier legislation introduced in the 90th Congress -- would encounter constitutional difficulties. Accordingly, Senator McClellan instead endorsed an approach that would create a broad list of predicate offenses, including various types of fraud, because

organized crime had shown great flexibility in branching into additional illegal activities and "if we name one crime they will commit another." Congress, the Senator explained, could not "anticipate everything;" it would "have to make a statute general." 116 Cong. Rec. 845-846 (1970).

Under this approach, the Department of Justice, which was to have exclusive authority to enforce this criminal statute, would thus have the power and the responsibility to channel the statute against its intended target: organized crime. Significantly, when this Committee broadened the statute to include mail fraud, wire fraud, and securities fraud as predicates that could give rise to RICO prosecution, the bill still provided for enforcement solely in cases prosecuted by the Justice Department.

These broad provisions, therefore, could not have been intended to expose legitimate businessmen to massive private suits, since the Senate bill did not even authorize private suits. With little discussion, however, the House Judiciary Committee later added the private civil remedy, including its provision for treble damages and attorney's fees. No one involved in proposing that amendment, however, suggested that it was to revolutionize federal law applicable to business or securities transactions or was to federalize local commercial disputes. Vividly illustrating the view that this addition did not alter the essential nature of the bill, the Committee's report devoted only a single, bland sentence to the new provision:

"The title, as amended, also authorizes civil treble damage suits on the part of private parties who are injured." H.R. Rep. No. 1549, 91st Cong., 2d Sess. 58 (1970).

In the House debates that led to passage of the bill as reported, the Members gave scant attention to this aspect of the bill. Instead, the debate was dominated by controversy over the breadth of the enforcement powers being conferred upon the government, not only in the RICO title but in other provisions as well. See generally 116 Cong. Rec. 35,191-217, 35,287-363 (1970). The House, too, in evaluating the RICO provisions, was mainly concerned with the infiltration of organized crime figures into businesses across the nation. Thus, Congressman Poff, a leading proponent of the legislation, pointed to the takeover of a jukebox business by "a mafia boss" as an illustration of the general understanding that RICO was meant to prevent organized crime from injuring legitimate business people. 116 Cong. Rec. 6709 (1970).

Since the amended bill returned to the Senate near the adjournment of the Congress, the Senate accepted it without a conference. This chamber did so, however, without any suggestion that the focus of Congressional concern had shifted in the slightest from the goal of punishing hard-core criminals through federal prosecution. Indeed, Senator McClellan described the House amendments, including the addition of the provision for private civil suits, as relatively "minor changes." 116 Cong. Rec. 36,293 (1970).

At no time did any supporter of the RICO bill ever suggest that the private civil remedy was intended for use against legitimate business people, corporations, and licensed professional partnerships, or was to be used in commercial disputes having nothing whatsoever to do with the activities of what was and is commonly understood as "organized crime."

In fact, though, that is precisely how civil RICO is being used. The insertion of a broad private right of action into the sweeping, Senate-passed organized crime bill allowed any victim of a pattern of so-called "racketeering activity" to sue in federal court and recover treble damages, plus attorney's fees. With increasing frequency, this seemingly meritorious device for redressing the injuries inflicted by organized crime has been turned against ordinary businesses -- the very people the act intended to protect. Among those who have found themselves targeted by "racketeering" allegations -- and please remember it only needs to be alleged that criminal violations have occurred -- have been this Nation's leading and most respected accounting firms, banks, insurance companies, securities firms, and many other legitimate business people.

This Committee is well aware of the structure of a RICO claim, and it would serve no useful purpose to detail all of its elements. To explain how civil RICO has come to be so distorted and abused, I should merely note that the commission of any two proscribed acts within a ten year period may trigger the statute and the availability of the

treble damage claim. Some of these so-called "predicate" offenses are those of a hard-core nature often associated with organized crime: murder, kidnapping, extortion and arson. But also included are some offenses subject to broad interpretation, such as mail fraud, wire fraud, and fraud in the sale of securities.

Allegations of fraud can be easily framed in almost any business transaction gone awry. And this is exactly what has happened in the RICO arena. The statute is now being invoked in every kind of litigation where a disgruntled investor, purchaser, or business associate can possibly allege that another party to the transaction did not deal fairly with him. Under the criminal mail and wire fraud test, this kind of allegation appears to be sufficient to constitute "fraud". In fact, the use of civil RICO becomes more ludicrous every day, encompassing breach of contract actions, commonplace landlord-tenant or real estate disputes, product liability actions, wrongful discharge from employment cases, matrimonial controversies, political squabbles, and even religious disputes.

The result has been, as Justice Marshall wrote for four members of the Court in the recent Sedima decision -- and the other five Justices did not dispute this point -- to "quite simply revolutionize[] private litigation." Civil RICO has disrupted the system of civil litigation in two major respects. First, it has federalized large portions of law traditionally reserved to adjudication in the state

courts under state law. Second, it allows plaintiffs to bypass carefully structured systems of rights and remedies in such areas of federal law as securities regulation; plaintiffs can do this simply by converting a securities law claim into a RICO claim based on two instances of mail or wire fraud.

Moreover, the mere allegation of racketeering activity under the statute is damaging. Few professionals or businesses dependent on maintaining a reputation for integrity dare risk the harm that may result from this type of publicity, even if confident that the litigation would prove unsuccessful. As Justice Marshall explained in Sedima:

"[M]any a prudent defendant, facing ruinous exposure, will decide to settle even a case with no merit. It is thus not surprising that civil RICO has been used for extortive purposes, giving rise to the very evils it was designed to combat."

According to comprehensive data recently collected on hundreds of civil RICO cases by the American Bar Association's Special RICO Task Force, 91% of all civil RICO cases rely primarily or solely on the securities, wire or mail fraud predicates of this organized crime statute. Only 9% of all civil RICO cases involve underlying allegations of criminal activity of the type generally associated with professional criminals. The statute thus has become primarily a tool for civil litigants to avoid the carefully crafted limitations of the federal securities laws and to federalize a wide variety of local commercial disputes.

In his testimony before this Committee in May addressing the need for civil reform, Assistant Attorney General Trott of the Department of Justice reported that the Department's own survey of private RICO cases confirmed this pattern of massive abuse. He estimated that, as a result of the increasing use of civil RICO in commercial disputes, the actual number of private cases filed already exceeds 500. According to the Justice Department's calculations, only about 7% of these cases involve either actual organized crime figures or the kinds of criminal conduct common to organized crime syndicates. As Assistant Attorney General Trott concluded:

"Experience has shown . . . that the instances of private civil RICO's use against traditional organized crime activities are far outweighed by example of its application as a general federal anti-fraud remedy against seemingly reputable businessmen."

Relying on surveys of this type, the Supreme Court accurately remarked in the recent Sedima decision, "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors" and that these suits are "being brought almost solely against" what it called "respected businesses" rather than against "the archetypal, intimidating mobster." In the wake of the Supreme Court's recent decisions in Sedima S.P.R.L. v. Imrex Co. and American National Bank & Trust Co. v. Haroco, the invocation of RICO against what Assistant Attorney General Trott called "conduct bearing little resemblance to organized

crime activity in the traditional sense" is almost certain to accelerate.

To eliminate the well-documented and widely recognized abuses of civil RICO and to refocus the statute on its intended targets, Congress should permit civil claims under RICO to proceed only after the defendant has been convicted of a RICO offense or of at least one of the predicate offenses. Under the kind of amendment that we urge, a plaintiff bringing a private treble damage action under this special "organized crime" statute should have to prove that:

- (1) the defendant violated the provisions of RICO by engaging in conduct that violated 18 U.S.C. § 1962, as is currently required;
- (2) the defendant has been convicted either of a RICO violation or of one of the predicate acts based on the conduct upon which the plaintiff bases his civil RICO claim, a new provision;
- (3) the plaintiff has been injured by the defendant's violation of Section 1962, as the statute presently requires; and
- (4) the civil claim is filed within one year of the latest pertinent criminal conviction, a new provision.

Such an amendment would confine the situations in which suits can be filed to those in which public prosecutors have screened those people who may fairly be charged with being involved in real criminal activity from those who should not be subject to accusations of "racketeering." I emphasize that, if Congress enacts this kind of amendment,

persons allegedly injured by conduct that has not lead to criminal prosecution and conviction would still have available all the other federal and state law remedies that apply to commercial disputes and alleged torts. The prior-criminal-conviction requirement would be the most direct and precise way to return RICO to its intended use as a weapon against career criminals, and its abuse as a weapon in ordinary commercial litigation would end.

I am aware that people who are eager to preserve the potent leverage that civil RICO gives them in commercial litigation have repeatedly recited a laundry list of so-called problems with a prior-criminal-conviction requirement. Through repetition -- and because to date these claims have generally gone unanswered -- these assertions have taken on more credence than they deserve. When those so-called problems are examined, however, each evaporates. I do not have the time to go through those objections one by one and explain why they do not carry much weight, but we have done so in our more detailed memorandum on the subject of civil RICO that I am submitting as an Appendix to my statement and I ask that it be included in the record. That memorandum puts to rest the notion that a prior-criminal-conviction requirement would create any insurmountable difficulties or any greater problems than those that accompany any change in the law. In examining the so-called problems created by a prior-criminal-conviction requirement, the Committee should of course not lose sight of the tremendous problems that

would result from a failure to act: the growing use of civil RICO to revolutionize ordinary commercial litigation.

The need for reform is clear. Congress should move promptly to amend the civil provisions of RICO to restore the private remedy to its original purpose as an additional weapon against organized crime, while curing its current capacity to inflict harm and unreasonable costs on legitimate businesses.

Exhibit A

Amend subsection (c) of 18 U.S.C. § 1964 ("Civil remedies") to read as follows (new matter underscored, deleted matter bracketed):

* * *

"(c) Any person injured in his business or property by reason of conduct in [a] violation of section 1962 of this chapter may sue [therefor] any person who engaged in that conduct and, with respect to such conduct, was convicted of racketeering activity or a violation of section 1962 in any appropriate United States district court, and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee. A civil action under this subsection may not be commenced against a defendant later than one year after the entry of the latest judgment of conviction against the defendant for racketeering activity or a violation of section 1962 with respect to the conduct out of which such action arises."

* * *

EXPLANATION

This amendment would limit the abuse of RICO's private, civil treble-damage mechanism under which claimants in many types of commercial disputes have been able to gain unwarranted leverage for their positions by branding their adversaries "racketeers." The amendment would implement

Congress' judgment that the use of RICO's powerful weapons against "organized crime" should rest on the expertise and discretion of public prosecutors. The amendment would achieve those objectives by making it clear that the civil treble-damage provision is to be used only against persons whom prosecutors have decided to charge and whom juries have decided to convict of criminal violations of RICO or of the underlying "predicate" offenses.

Under this amendment the civil remedy would dovetail with the careful screening performed by the Department of Justice in applying its guidelines to distinguish cases that are properly subject to the special RICO provisions from those that are not. It also would rely on determinations by federal and local prosecutors and juries that the defendants were actually engaged in criminal activity. Accordingly, the special civil treble-damage provisions of RICO would be directed only at those persons who may fairly be viewed as engaged in the business of "organized crime." Ordinary commercial disputes and tort claims would be left exclusively to the other federal or state remedies that appropriately apply to them.

UNITED STATES SENATE

COMMITTEE ON THE JUDICIARY

Hearings on Civil RICO

July 31, 1985

"The Authority To Bring
Private Treble-Damage Suits
Under 'RICO' Should Be Reformed"

APPENDIX TO STATEMENT OF
RAY J. GROVES, CHAIRMAN,
AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS

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THE AUTHORITY TO BRING
PRIVATE TREBLE-DAMAGE SUITS
UNDER "RICO" SHOULD BE REFORMED

This memorandum details some of the serious problems that have arisen with the authorization for private treble-damage suits under the Racketeer Influenced and Corrupt Organizations ("RICO") title of the Organized Crime Control Act of 1970, 18 U.S.C. § 1961 et seq. It explains why reform of those provisions is necessary now, and why the amendment of the private civil action section to establish a prior-criminal-conviction requirement is the best solution available.

I. INTRODUCTION

With little discussion, the House of Representatives in 1970 added the provision for private civil suits to a Senate-passed bill that was primarily designed to give the Department of Justice new criminal enforcement tools to attack "the mob." The Senate had drafted a bill with broad language in order to give the Justice Department adequate latitude in prosecuting persistent offenders, even if they were not members of traditional criminal syndicates. It was expected, however, that the Justice Department, in exercising its enforcement discretion, would be faithful to the expressed congressional purpose to direct the new criminal sanctions against "organized crime," as experienced prosecutors understand that term. The Justice Department, in fact, has adopted formal guidelines to avoid abusive or excessive use of the broad language of RICO,

and has exercised discretion in selecting cases for prosecution under RICO. See pp. 46-50, infra.

The provision for private civil suits was added very late in the legislative process and was intended to have the same focus: protecting legitimate businesses from incursions by professional criminals. Congress neglected, however, to include any specific mechanism to confine private civil suits to cases involving the activities of "organized crime."

Private claimants invoking the broadly phrased statute have not shown any of the discipline exercised by the Justice Department in its selective use of this powerful new weapon. As a result, inventive private lawyers seeking treble damages are successfully arguing for the most sweeping interpretation of RICO's broad language and are attempting to apply RICO in contexts far removed from those conceived by the statute's supporters. RICO claims are now added as a matter of course in virtually all cases challenging securities transactions or alleging some type of commercial fraud. RICO also crops up in landlord-tenant and real estate disputes, attorney-client conflicts, and even divorce battles. By contrast, only a tiny handful of the hundreds of cases alleging private civil claims under RICO involve either the people or the conduct that supporters of the bill sought to attack.

Without any of the restraint and responsibility that governs the decisions of public prosecutors, private lawyers are invoking civil RICO on behalf of private clients

to level charges of "racketeering" against reputable businessmen and professionals such as investment bankers, brokers, and accountants. Although RICO was intended to protect legitimate business, the statute is now being used almost exclusively to attack established businesses and firms. The threat to bring a "racketeering" charge sometimes coerces settlements before the filing of a RICO complaint, while the actual filing of a RICO complaint exposes businessmen to continuing embarrassment and expense.

The Supreme Court has now held that the courts do not have the authority to stop the misuse of civil RICO, and that only Congress may do so. In its recent decision in Sedima, S.P.R.L. v. Imrex Co., ___ U.S. ___, 53 U.S.L.W. 5034 (July 1, 1985) ("Sedima"), the Court unanimously recognized that RICO is being used in ways unintended by Congress, as a weapon against legitimate businessmen in ordinary commercial disputes. A bare majority of the Court, however, held that this unfortunate result "is inherent in the statute as written, and its correction must lie with Congress." 53 U.S.L.W. at 5039. Thus, the unintended targets of RICO actions have little or no hope of relief from the courts. The misuse repeatedly noted by commentators and courts alike, including now the United States Supreme Court, can only be eliminated by congressional action.

II. THE STRUCTURE OF THE RICO STATUTE PERMITS
OVERLY BROAD USE BY PRIVATE PLAINTIFFS

The private civil RICO section is 18 U.S.C. § 1964(c).

Under that provision, a person may press a civil RICO claim if he alleges that he was "injured in his business or property by reason of" the defendant's "pattern of racketeering activity." The plaintiff may recover treble damages as well as costs and attorney's fees. The private civil claim under RICO involves three main components.

A. Predicate Offenses:
"Racketeering Activity"

Congress doubted that it could adequately define "organized crime" in a criminal statute in a way that would pass constitutional muster. It chose instead to focus on the types of conduct in which organized crime figures engage. The key to RICO coverage is an extensive list of "predicate" offenses that are defined as constituting "racketeering activity." 18 U.S.C. § 1961. These include a variety of violent crimes, such as murder, kidnapping, extortion, and arson -- crimes that one normally associates with organized crime. In addition, because of some indications from the SEC staff that organized crime figures were involved in trafficking in stolen or counterfeit securities and similar kinds of activity, the SEC asked the Senate to expand the list of predicate offenses in its bill to include mail fraud, wire fraud, and "fraud in the sale of securities." See p. 30, infra.

B. "Pattern" of Racketeering Activity

The commission of at least two predicate acts within a ten year period is defined to be a "pattern" of racketeering activity. The initial step in a plaintiff's civil RICO claim is to assert that a "person" -- including the whole spectrum of legitimate business corporations, associations, partnerships, and their executives -- committed two predicate acts within ten years and thus engaged in a "pattern of racketeering activity."

Unfortunately, this sweeping coverage makes virtually any businessman or business organization a potential target of a RICO claim. Since the two predicate offenses may not need to be separated in time or involve different transactions, a claimant may allege that a single commercial transaction that generates a dispute constitutes a "pattern of racketeering." For example, an investor may allege simply that a securities transaction consisting of two steps involved fraud. This allegation may make out a "pattern of racketeering activity" involving "fraud in the sale of securities." Similarly, a would-be RICO plaintiff may assert that two separate copies of a financial statement, bill, contract, advertisement or other document involved in an allegedly "fraudulent" transaction were sent through the mails. As Justice Marshall, writing for four Justices of the Supreme Court in the Sedima case, recognized, "the effects of making a mere two instances of mail or

wire fraud potentially actionable under civil RICO are staggering," 53 U.S.L.W. at 5040, because of the breadth of those statutory provisions.

C. "Enterprise" Requirement

RICO also requires that the person commit the predicate acts in a particular relationship to an "enterprise." Under the statute, it is unlawful to obtain any interest in an "enterprise" through a pattern of racketeering activity, to control an enterprise through such activity, or to conduct the affairs of an enterprise through racketeering activity. 18 U.S.C. § 1962. Depending on the facts, a plaintiff can easily satisfy the "enterprise" requirement in actions against legitimate businesses or businessmen by alleging that, for example, the defendant corporation or professional partnership is the "enterprise" that is conducting its affairs improperly.

III. THE LEGISLATIVE DEVELOPMENT OF CIVIL "RICO" SHOWS A PURPOSE TO PROTECT LEGITIMATE BUSINESSES

The bill that became the 1970 Organized Crime Control Act, including the RICO title, originated in the Senate. The Senate report stated unambiguously the objective of the legislation:

"[T]he eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime." S. Rep. No. 617, 91st Cong., 1st Sess. 2 (1969) (emphasis added).

In this vein, Senator McClellan, the bill's chief sponsor and a longtime foe of organized crime, focused his arguments for the bill on the insidious activities of "La Cosa Nostra." 116 Cong. Rec. 585-86 (1970). In particular, his sponsorship reflected awareness that, when "organized crime moves into a business, it usually brings to that venture all the techniques of violence and intimidation which it used in its illegal businesses." 115 Cong. Rec. 5874 (1969). The Senate wanted to provide a mechanism to respond to reports that "organized crime has begun to penetrate" some legitimate businesses, such as securities firms from which it was stealing securities. See S. Rep. No. 617, supra, at 77; 116 Cong. Rec. 591 (1970) (remarks of Sen. McClellan).

The House shared this concern about the infiltration of organized crime into businesses across the nation. Thus, when Congressman Poff, a leading proponent of the legislation, pointed to the takeover of a jukebox business by "a mafia boss," he illustrated the general understanding that RICO was meant to protect legitimate business people injured by organized crime. 116 Cong. Rec. 6709 (1970).

The Senate RICO bill had contained no provision for private civil suits when Senator McClellan introduced it, when the Judiciary Committee added the fraud predicates, or when the Senate initially passed the bill. A private civil remedy finally was added to the RICO legislation in the House Judiciary Committee at the urging of Representative Steiger, who

submitted the draft of the language that ultimately became law. In submitting the amendment, Representative Steiger explained that his proposal was designed to add a private remedy to help in the fight "to deal with organized crime." Organized Crime Control: Hearings Before Subcommittee No. 5 of the Committee on the Judiciary on S. 30 and Related Proposals Relating to the Control of Organized Crime in the United States, 91st Cong., 2d Sess. 519 (1970). He carefully emphasized his understanding that RICO was designed "to prevent and reverse the corrupt infiltration of legitimate commercial activities by ruthless organized criminals." Id. So as to leave no room to doubt that he expected that the new statute, including his civil damage remedy, would be directed against "ruthless, organized criminals," Representative Steiger described examples of penetration of legitimate businesses by various "families" of "La Cosa Nostra" -- the Mafia. Id. In the sparse debate on the civil damage provision when the bill reached the House floor, the Chairman of the House Judiciary Committee, Representative Celler, explained that the addition of a treble-damage remedy was to be one of the tools "designed to inhibit the infiltration of legitimate business by organized crime." 116 Cong. Rec. 35,196 (1970).

The bill returned to the Senate shortly before adjournment, and the Senate accepted the amended version without seeking a conference. In doing so, however, no one suggested that the focus of congressional concern --

protection of legitimate businessmen -- had shifted in the slightest. Indeed, Senator McClellan described the House amendments, including the addition of the civil provision, as "comparatively . . . minor changes." 116 Cong. Rec. 36,293 (1970). At no time did any supporter of the bill suggest that the private civil remedy was intended for use against legitimate business people, corporations, or partnerships of licensed professionals, or was to be used in commercial disputes having nothing whatever to do with the activities that were and are commonly recognized as "organized crime."

IV. THE USE OF THE PRIVATE CIVIL DAMAGE
PROVISION HAS ACTUALLY UNDERMINED
THE CONGRESSIONAL OBJECTIVE

In light of the unambiguous congressional focus, civil RICO actions should closely parallel criminal prosecutions. Instead, civil RICO is used almost exclusively in commercial disputes, against what Assistant Attorney General Stephen S. Trott, in testifying on RICO before this Committee on May 20, 1985, called "conduct bearing little resemblance to organized crime activity in the traditional sense." The statute is now being invoked in every kind of litigation where a litigant can possibly allege the predicate offense of "fraud". Virtually all of these claims are either covered by specific federal regulatory laws such as the securities laws or do not belong in the federal courts at all. In the vast majority of cases, civil RICO claims are being used as weapons against the very people Congress was seeking to protect: legitimate

business people. Not only have these developments distorted congressional expectations, but they also present widely recognized and increasing opportunities for abuse.

A. The Ability Of A Private Lawyer
To Charge A Person With Criminal
"Racketeering" Is Easily Abused

RICO is unprecedented in authorizing private lawyers who are representing purely private clients to invoke the judicial process by charging another private person with crimes. Under RICO, the private lawyer exercises power that normally is reserved to public officials and grand jurors: the power to lodge a formal accusation of crime. Those public officials and grand jurors, of course, have a duty of fairness and restraint in deciding whether to make that kind of accusation. As the Supreme Court once described the special responsibilities of prosecutors:

"The United States Attorney is the representative not of an ordinary party to a controversy, but of a sovereignty whose obligation to govern impartially is as compelling as its obligation to govern at all; and whose interest, therefore, in a criminal prosecution is not that it shall win a case, but that justice shall be done. As such, he is in a peculiar and very definite sense the servant of the law, the twofold aim of which is that guilt shall not escape or innocence suffer." Berger v. United States, 295 U.S. 78, 88 (1935).

A private lawyer, by contrast, owes allegiance to his client's private interest, not to a higher sense of justice. His interest is not in impartiality, but in partisan advocacy. He is his client's servant, not the servant of the

law. His client's interest is not that "justice" be done, but that he obtain money from the defendant.

Because of these fundamental differences, our system surrounds the exercise of prosecutorial power with many legal and ethical restrictions not applicable to the private attorney. The officials who exercise prosecutorial discretion are accountable to the public for their judgments. As a further shield against overzealousness, the Constitution interposes grand jurors who, like the prosecutor himself, are sworn to secrecy while the prosecutor is attempting to demonstrate that there is substantial evidence to justify a proposed criminal charge. None of these restrictions, however, applies to a private lawyer who is considering filing a civil lawsuit in order to promote his client's financial interests.

The private claimant's power to brand a businessman or firm a "racketeer" may cause almost as much irreversible injury to the legitimate businessman as may an unwarranted criminal charge. Business rivals may use this power to gain economic advantage without actually having to go beyond the threat to file a civil RICO suit. The people who are monitoring the actual use of civil RICO know that this is the reality, not mere speculation. As Justice Marshall noted in the Sedima decision: "[T]he defendant, facing a tremendous financial exposure in addition to the threat of being labelled a 'racketeer,' will have a strong interest in settling the dispute."

53 U.S.L.W. at 5041. Ironically, therefore, civil RICO creates an opportunity for civil claimants to engage in a form of extortion, even though the criminal features of the statute are geared to prevent similar exactions by organized crime figures.

Several recent RICO cases illustrate the full range of the distortion to which the present language of the civil RICO provision lends itself and the difficulties the courts are having in applying the statute sensibly. In at least two instances RICO has been invoked in religious squabbles, and the trial judges have struggled to make RICO inapplicable. In Van Schaick v. Church of Scientology, Inc., 535 F. Supp. 1125 (D. Mass. 1982), the district court was faced with a claim brought by a disaffected former adherent of the Scientologists alleging fraudulent misrepresentations. The RICO claim in Congregation Beth Yitzhok v. Briskman, 566 F. Supp. 555 (E.D.N.Y. 1983), turned on a dispute about the proper succession to the "Skolyer Rebbe," a Chassidic Jewish leadership position. The plaintiffs invoked "mail fraud" and other predicate offenses based on alleged misrepresentations by the defendants about their right to administer the congregation.^{1/}

The bizarre uses to which RICO may be put are not limited to religious disputes. RICO is being used as well in

^{1/} The district court dismissed the suit on the ground that the religious issues were non-justiciable. 566 F. Supp. at 558.

disputes between spouses and over inheritance. See Report of the Ad Hoc Civil RICO Task Force of the ABA Section of Corporation, Banking and Business Law ("ABA RICO Task Force Report") 39 n.41 (1985). In another recent case, a RICO suit was filed against former Vice President Walter Mondale, the Democratic National Committee and several individual members of the DNC, alleging that the defendants offered political contributions to other Democratic candidates in exchange for promises not to oppose Reagan Administration policies. While the court dismissed the claim, it did so solely on the ground that the plaintiffs had failed to allege acts that fell within the predicate acts specified in the statute. Taylor v. Mondale, Civ. No. 84-3149 (D.D.C. May 7, 1985), reported in Civil RICO Report (BNA), June 5, 1985, at 6. Thus, the court found nothing wrong with the basic use of RICO, only with the choice of the particular criminal acts pleaded as predicate offenses. In addition, at least one federal court has held that the fraud predicates supported a civil RICO claim for damages against FBI agents who orchestrated an undercover "sting" operation. Lightner v. Tremont Auto Auction, No. 82C 20090 (N.D. Ill. June 29, 1984), reported in 1 RICO Litigation Reporter 317 (September 1984). It is hard to imagine a more glaring illustration of the point that civil RICO is now being used against the very people it was designed to aid.

B. Civil RICO Suits Are Directed
Mostly At Well Established
Businesses, Not Organized Crime

The American Bar Association's special RICO Task Force recently collected comprehensive data about hundreds of private civil RICO cases, almost all of which have been reported since 1982.^{2/} The Report classified the essential allegations underlying the RICO charges as follows:

<u>Percentage</u>	<u>Underlying Allegation</u>
40%	securities fraud
37%	common law fraud in a commercial setting
4%	antitrust or unfair competition
4%	bribery or commercial bribery
3%	other fraud
2%	labor disputes
1%	theft or conversion
9%	offenses associated with professional criminal activity ^{3/}

Another private survey located 132 civil RICO cases in which opinions have been published. According to the descriptions of allegations contained in those cases, they fall into the following categories:

^{2/}ABA RICO Task Force Report at 53, 55 (of the cases collected in the Report's database, 3% were decided prior to 1980, 2% were decided in 1980, 7% in 1981, 13% in 1982, 33% in 1983, and 43% in 1984).

^{3/}Id. at 55-56.

Securities transactions	57
Commercial and contract disputes	38
Commodities trading	6
Bank loans	6
Antitrust price fixing	3
Religious disputes	2
Divorce	1
Union affairs	3
Commercial bribery/kickbacks	2
Political corruption (including official extortion and bribery)	9
Theft (by cleaners from apartment dwellers)	1
Violent crimes (murder, arson, extortion)	3

Thus, cases that could fairly be characterized as having anything to do with aiding the war on organized crime are a tiny minority.^{4/}

In his recent testimony before the Senate Judiciary Committee on the need for civil RICO reform, Assistant Attorney General Trott of the Department of Justice reported that the Department's own survey of private RICO cases confirmed this pattern of massive abuse. He estimated that, as a result of

^{4/} Both the majority and minority opinions in the Sedima accepted and cited these statistics. 53 U.S.L.W. at 5039 n.16, 5041. Both recognized that this result was not what Congress intended; they diverged only on the question whether the courts may properly do anything to prevent future use of the statute in this manner. The majority concluded that this is a task for Congress, not the courts. See pp. 31-35, infra.

the increasing use of civil RICO in commercial disputes, the actual number of private cases filed already exceeds 500. According to the Justice Department's calculations, only about 7% of these cases involve either actual organized crime figures or the kinds of criminal conduct common to organized crime syndicates. As Assistant Attorney General Trott concluded:

"Experience has shown . . . that the instances of private civil RICO's use against traditional organized crime activities are far outweighed by example of its application as a general federal anti-fraud remedy against seemingly reputable businessmen."

On some occasions, private plaintiffs have used civil RICO to pursue people who had first been prosecuted and convicted of the predicate acts or RICO itself. The three civil RICO cases noted in the private survey of 132 cases which involved allegations of gangster-like conduct -- murder, arson and extortion -- were cases filed after the authorities had obtained criminal convictions. See Anderson v. Janovich, 543 F. Supp. 1124 (W.D. Wash. 1982) (tavern owner claimed that convicted competitors tried to control local tavern business through threats of murder and arson); State Farm Fire and Casualty Co. v. Estate of Caton, 540 F. Supp. 673 (N.D. Ind. 1982) (insurance company sought to recover fraudulently obtained proceeds after convictions in arson-for-hire case); City of Milwaukee v. Hansen, No. 77-C-246 (E.D. Wis. January 13, 1981) (city sought to recover costs incurred in fighting fires started by convicted arsonists). In addition, about a

dozen other civil RICO cases have followed criminal convictions, generally for some form of political corruption. In one recent case, the Seventh Circuit upheld a RICO judgment against a defendant sued after he had pleaded guilty to charges of mail fraud based on the same conduct. See McCullough v. Suter, 757 F.2d 142 (7th Cir. 1985). In another recently filed action, a corporation brought RICO claims against, inter alia, two individuals who had recently pleaded guilty to federal securities law violations. Anheuser-Busch Companies, Inc. v. Thayer, No. 3-85-0794-R (N.D. Tex.; complaint filed April 26, 1985), reported in Racketeer Litigation Reporter at 695 (May 1985). RICO thus can be, and has been, used to pursue civil remedies against convicted felons.

In most civil RICO cases, however, the public authorities have not found a basis to proceed with any criminal charges. There has been, therefore, no careful screening by publicly accountable officials before private claimants have charged those defendants with criminal "racketeering." This is not surprising, because public officials would not have considered it fair or accurate to brand the defendants in these cases "racketeers." Indeed, one commentator, who maintains the computerized database of civil RICO decisions upon which the ABA RICO Task Force relied and who served as Executive Director of that Task Force, concluded that, "realistically speaking, the likelihood of state or federal prosecutors seeking indictments in the vast majority of these types

of cases is as close to zero as anything could be." Weissman, "Circuit Aims To Curb Private Civil RICO Actions," Legal Times, August 20, 1984, at 12. Thus, these civil cases are not supplementing the enforcement efforts of prosecutors who simply lack the resources to deal with all the offenses deserving prosecution. Instead, these cases involve, with rare exceptions, disputes that no responsible prosecutor would brand as criminal, much less as the manifestations of "organized crime" or "racketeering."

Although the burden of RICO's misuse does not fall solely on persons in the financial community and in related professional services, the burden has become especially severe for these people because they are viewed as vulnerable "deep pockets" whenever an investment or a commercial transaction goes sour. As The New York Times reported, despite the expectation that civil RICO would focus on "mobster deals," "legitimate businesses" such as Morgan Stanley, American Express, and Lloyd's of London have "found their names smeared with racketeering charges. . . ." N.Y. Times, September 4, 1984, at D2.^{5/} A partial roster of defendants in civil RICO suits includes the following established and respected entities that private claimants have charged with a "pattern of racketeering":

^{5/} In light of civil RICO's unintended use as a weapon against "ordinary enterprises," The New York Times recently called for a legislative "repair job" on RICO's civil treble-damage provisions. "Where To Fix The Rackets Law," N.Y. Times, July 8, 1985, at A16.

Investment bankers and brokers

Bache Halsey Stuart Shields, Inc.
 Bear Sterns & Co.
 Dean Witter Reynolds
 Lehman Brothers Kuhn Loeb, Inc.
 Loeb Rhodes & Co., Inc.
 Merrill Lynch, Pierce Fenner & Smith, Inc.
 Morgan Stanley & Co., Inc.
 Oppenheimer & Co.
 Paine Webber Jackson & Curtis, Inc.
 Shearson/American Express, Inc.
 Thomson McKinnon Securities, Inc.

National C.P.A. Firms

Alexander Grant & Company
 Arthur Andersen & Co.
 Coopers & Lybrand
 Ernst & Whinney
 Laventhol & Horwath
 Peat Marwick Mitchell & Co.
 Price Waterhouse
 Touche Ross & Co.

Law Firms

Lord, Bissel & Brook
 Pierson, Ball & Dowd
 Singer, Hutner, Levine & Seemans
 Sullivan & Worchester

Banks

Citibank, N.A.
 Continental Illinois National Bank & Trust Co.
 Crocker National Bank
 First American Bankshares, Inc.
 First Interstate Bank of Oregon
 First National Bank of Atlanta
 First National Bank of Maryland
 Marine National Bank (Wisconsin)
 National Republic Bank of Chicago
 Pacific Western Bank
 Riggs National Bank of Washington, D.C.
 Sierra Federal Savings & Loan Association
 Southwest National Bank
 State Bank of India
 Union Bank

Insurance Companies

Allstate Insurance Co.
 Lincoln Insurance Co.
 Prudential Insurance Co. of America
 State Farm Mutual Automobile Insurance Co.
 Travelers Insurance Co.
 Underwriters of Lloyd's, London
 USLIFE Corp.

Manufacturing Companies

A.H. Robins Co., Inc.
 Boeing Co.
 Continental Group, Inc.
 General Motors Corp.
 Miller Brewing Co.
 Mitsui & Co. (U.S.A.), Inc.
 Rockwell International Corp.
 Rohm & Haas Co.

Firms like those have been named as defendants in dozens of civil RICO suits, even though the Justice Department has not seen merit enough even to file criminal charges against them, much less to obtain convictions. Of course, the enormous expenses associated with defending against unchecked civil RICO claims become a cost of doing business that ultimately taxes the consumers of the goods and services provided by these firms and by their customers and clients.

C. Civil RICO Is Used Most Extensively
 In Ordinary Commercial Disputes

As the figures demonstrate, the vast bulk of private civil RICO cases have come in commercial contexts -- hardly in the settings that Congress thought needed bold new weapons or special incentives to sue. All its sponsors expressly agreed that RICO was aimed at preventing the infiltration of legitimate business by organized crime.

The draftsmen certainly did not intend, for example, to have RICO become a device for challenging corporate takeover bids or to add a new level of regulation of those hotly contested deals. Yet, as SEC member Charles Marinaccio told this Committee in May of this year, "[i]t has become standard practice to add a RICO charge to lawsuits challenging tender offers." Statement of Charles L. Marinaccio, Member of the Securities and Exchange Commission, Before the Committee on the Judiciary, United States Senate, May 20, 1985, at 3; see, e.g., Dan River, Inc. v. Icahn, 701 F.2d 278 (4th Cir. 1983); Gearhart Industries, Inc. v. Smith International, Inc., 592 F. Supp. 203 (N.D. Tex.), modified, 741 F.2d 707 (5th Cir. 1984). In Dan River, Inc. v. Icahn, supra, the court of appeals expressed concern about attempts to use RICO to block a takeover bid through a public tender offer, pointing out that this is simply one illustration of the unintended and excessive use of civil RICO:

"Finally, we note the mounting controversy in the federal courts over the proper limits, if any, upon the use of RICO in cases far removed from the context which Congress had in mind when it enacted the statute. Congress was out to attack the problem of organized crime, not the problem of corporate control and risk arbitrage. We of course make no attempt to resolve the dispute here and now. We do not propose to enter the fray. We only note that the reach of RICO is itself a troubling issue" 701 F.2d at 291.

See also Tyson & August, The Williams Act After RICO: Has The Balance Tipped In Favor Of Incumbent Management?, 35 Hastings L.J. 53, 111-12 (1983) ("By giving target management a powerful

new weapon in the takeover battle, the judicial approval of RICO suits predicated on Williams Act violations undermines the careful policy of evenhandedness that the Williams Act Congress sought so hard to attain").

The treble-damage weapon of RICO and the "racketeering" label are also being used to challenge the ways banks set up their loan procedures and terms. For instance, in Morosani v. First National Bank of Atlanta, 703 F.2d 1220 (11th Cir. 1983), the Eleventh Circuit has allowed a case to proceed on the claim that the "prime rate" used in computing the interest on the plaintiff's loan was not the bank's true prime rate. The Supreme Court recently agreed that RICO sweeps so broadly as to encompass such a case. See Haroco v. American National Bank & Trust Co., 747 F.2d 384 (7th Cir. 1984), aff'd, ___ U.S. ___, 53 U.S.L.W. 5067 (July 1, 1985) (per curiam). In Lode v. Leonardo, 557 F. Supp. 675 (N.D. Ill. 1982), the court explained why it, too, felt obliged to entertain a RICO suit involving alleged misrepresentations relating to a commercial loan:

"Congress may not have envisioned that the civil remedies it supplied in RICO would find the widespread use that they have in commercial fraud cases. And such use of RICO's remedies may well be somewhat undesirable. But, when a plaintiff makes allegations which appear to state a claim under the statute as it is written, it is not the function of this Court to reject that claim on the ground that Congress must have meant something other than what it said in the statute." 557 F. Supp. at 681.

RICO counts have already appeared in many other cases involving disputed commercial transactions, including churning of stock,^{6/} representations about a broker's expertise,^{7/} projections used in real estate syndication,^{8/} disputes between landlord and tenant,^{9/} disallowance of insurance claims,^{10/} alleged overcharges by a printer,^{11/} and failure to publish a medical journal according to a contractual agreement.^{12/} Because Congress included open-ended "fraud" predicates, there is ample room for transforming even more kinds of commercial disputes into RICO cases.

Although the "fraud" predicates are the easiest to abuse by artful pleading, they are not alone. In a recent decision, the Fourth Circuit ordered reinstatement of a civil RICO case brought by a condominium developer who alleged that

^{6/}See, e.g., Harper v. New Japan Securities International, Inc., 545 F. Supp. 1002 (C.D. Cal 1982).

^{7/}See, e.g., Noland v. Gurley, 566 F. Supp. 210 (D. Colo. 1983).

^{8/}Gordon v. Terry, 684 F.2d 736 (11th Cir. 1982), cert. denied, 459 U.S. 1203 (1983).

^{9/}Pit Pros, Inc. v. Wolf, 554 F. Supp. 284 (N.D. Ill. 1983).

^{10/}Barker v. Underwriters at Lloyd's, London, 564 F. Supp. 352 (E.D. Mich. 1983).

^{11/}Estee Lauder, Inc. v. Harco Graphics, Inc., 558 F. Supp. 83 (S.D.N.Y. 1983).

^{12/}American Society of Contemporary Medicine, Surgery & Ophthalmology v. Murray Communications, Inc., 547 F. Supp. 462 (N.D. Ill. 1982).

the purchasers of an office condominium unit were trying to "extort" an unreasonably high price from him in connection with the developer's effort to repurchase the condo unit in order to include it in a block of units the developer wanted to sell to IBM. Although the district court found that this was "at best a garden-variety commercial breach of contract" case, the Fourth Circuit concluded that the allegations might make out a claim of "extortion" under state law and, therefore, the plaintiff could press the case under RICO. Battlefield Builders, Inc. v. Swango, 743 F.2d 1060 (4th Cir. 1984). The two businessmen who originally bought the condominium unit -- and their wives as co-defendants -- now stand accused of being racketeers and must defend themselves against a statute that Congress believed would protect business people from, in Representative Steiger's words, "ruthless organized criminals."

D. The Inclusion Of Fraud-Based Predicate
Offenses Is The Source Of Most Of The
Abuse Of Civil RICO

Without doubt, the single most important aspect of RICO that permits plaintiffs to transform commercial disputes into federal treble-damage actions is the inclusion of "mail fraud," "wire fraud," and "fraud in the sale of securities" in the list of predicate offenses. The comprehensive survey by the ABA Special Task Force on Civil RICO ascertained that 91% of RICO claims appear in cases that involve sales of securities or commodities or relate to contract disputes or other ordinary commercial transactions. See ABA RICO Task Force Report at 55-56. Although Congress

added the fraud-based predicates at a time when RICO did not provide for a private remedy, and it added the private remedy at the last minute without careful consideration of how it would be used, the result, to quote the words of Justice Marshall in Sedima, "quite simply revolutionizes private litigation." 53 U.S.L.W. at 5040. Justice Marshall went on: "The single most significant reason for the expansive use of civil RICO has been the presence in the statute, as predicate acts, of mail and wire fraud violations." Id. He similarly recognized that the fraud-based predicates allow a plaintiff to bypass the federal securities laws in favor of a claim under RICO. Id. at 5041. The result, Justice Marshall and these other Justices realized, is "the federalization of broad areas of state common law of frauds, and . . . the displacement of well-established federal remedial provisions." Id. at 5040.

Claims based on "mail fraud" and "wire fraud" predicate offenses are easy to plead in many commercial disputes. They are also likely to survive motions to dismiss made at early stages. This is so because the underlying law in this area has been developed in criminal prosecutions under broadly worded criminal statutes. Courts have been willing to allow public officials to use broad prosecutorial discretion in determining which transactions are properly prosecutable:

"The crime of mail fraud is [broad] in scope. The fraudulent aspect of the scheme to 'defraud' is measured by a non-technical standard. Law puts its imprimatur on the accepted moral standards and condemns conduct which fails to match the 'reflection of moral uprightness, of fundamental honesty, fair play and right dealing

in the general and business life of members of society.' This is indeed broad." Blachly v. United States, 380 F.2d 665, 671 (5th Cir. 1967) (citations omitted).

In almost any instance where a venture has lost money, or a stock has fallen in value, a disappointed investor can allege that the businessman's behavior was not a "reflection of moral uprightness" and "fair play." As Justice Marshall noted in his opinion in Sedima:

"The effects of making a mere two instances of mail or wire fraud potentially actionable under civil RICO are staggering, because in recent years Courts of Appeals have 'tolerated an extraordinary expansion of mail and wire fraud statutes to permit federal prosecution for conduct that some had thought was subject only to state criminal and civil law.'" 53 U.S.L.W. at 5040, quoting United States v. Weiss, 752 F.2d 777, 791 (2d Cir. 1985) (Newman J., dissenting).

Justice Marshall recognized that "[t]he only restraining influence on the 'inexorable expansion of the mail and wire fraud statutes,' United States v. Siegal, 717 F.2d, at 24 (Winter, J., dissenting in part), has been the prudent use of prosecutorial discretion." 53 U.S.L.W. at 5040. The courts have permitted the expansive reading of the mail and wire fraud statute knowing full well that no private right of action existed under those criminal statutes. Id. Although Congress has never directly authorized private civil suits under the mail or wire fraud statutes, the inclusion of those offenses among the predicates for a civil suit under RICO now has given this vast discretion to private claimants through the back door.

The result, as Justice Marshall wrote, is an enormous expansion in federal jurisdiction over ordinary civil disputes:

"In the context of civil RICO . . . the restraining influence of prosecutors is completely absent. . . . [S]uch litigants, lured by the prospect of treble damages and attorney's fees, have a strong incentive to invoke RICO's provisions whenever they can allege in good faith two instances of mail or wire fraud. . . . The civil RICO provision consequently stretches the mail and wire fraud statutes to their absolute limits and federalizes important areas of civil litigation that until now were solely within the domain of the states." Id. at 5041.

As one former federal prosecutor recently wrote in calling for legislation to delete "the mail fraud and wire fraud statutes from the list of predicate acts required to bring a private civil RICO action:"

"[A] general problem with RICO, that the constraints of prosecutorial discretion and guidelines which limit its application in the criminal sphere are no bar to its private civil application . . . , is most acute when the underlying predicate statutes are mail fraud and wire fraud, since it is the breadth of these statutes, both actual and potential, that forms the basis for most of the recent expansion of civil RICO litigation." Rakoff, "Opinion," 1 RICO Litigation Reporter 206-07, 211 (September 1984).

Nothing in the legislative history of RICO suggests Congress intended to federalize local commercial disputes. Continued inclusion of "mail fraud" and "wire fraud" as predicates for civil RICO claims, however, allows private plaintiffs to disregard these concerns about federalism and to transform local disputes into federal cases simply because one of the parties used the mail or the telephone.

Similarly, private plaintiffs find it easy to level allegations of "securities fraud." Since the federal courts

are reluctant to dismiss complaints before a plaintiff has had a chance to pursue substantial discovery in a search of evidence to support his allegations of "fraud," these cases withstand initial challenges. Even if the predicate offense that a plaintiff must ultimately prove in a civil RICO case is criminal securities fraud, a plaintiff may not even have to allege -- much less prove -- a deliberate intent to defraud him. For example, in United States v. Natelli, 527 F.2d 311 (2d Cir. 1975), cert. denied, 425 U.S. 934 (1976), the court upheld the conviction of a partner in a major accounting firm. On the basis of a finding that he had "recklessly" conducted a corporate audit, he was convicted of assisting in the corporation's filing of a false proxy statement in violation of 15 U.S.C. § 78ff(a). The trial judge, in sentencing the accountant, indicated that no finding of actual knowledge of falsity was necessary for conviction:

"I think you are absolutely sincere when you say that you do not believe that you did anything wrong in this audit or audits. . . . But the tragedy is that the jury found that this was an audit or audits done with reckless disregard for what was really involved." United States v. Natelli, 74 Cr. 43 (S.D.N.Y.), Transcript of Sentencing at 12.

Thus, a plaintiff may be able to assert a viable RICO claim based on alleged "fraud in the sale of securities" simply by claiming that the defendants were reckless in their actions, and that, as a result, a "fraudulent" filing or similar securities law violation occurred.

Moreover, the result of converting securities fraud claims into RICO claims is to displace the carefully structured remedies of the federal securities laws. First, civil RICO has unwittingly created a treble-damage remedy for ordinary securities law violations even though "the federal securities laws contemplate only compensatory damages and ordinarily do not authorize recovery of attorney's fees." Sedima, 53 U.S.L.W. at 5041 (Marshall, J., dissenting). Second, under RICO the plaintiff can raise the non-monetary stakes as well, because now the defendant runs the risk of being branded a "racketeer." As Justices Marshall, Brennan, Blackmun, and Powell recognized, the result of this double-barrel risk is not justice, but capitulation:

"Many a prudent defendant, facing ruinous exposure, will decide to settle even a case with no merit. It is thus not surprising that civil RICO has been used for extortive purposes, giving rise to the very evils that it was designed to combat." Id.

Third, and perhaps most important, this use of civil RICO "virtually eliminates decades of legislative and judicial development of private civil remedies under the federal securities laws." Id. This end-run around the requirements of the securities laws is possible because a RICO plaintiff can simply allege a RICO violation based on mail or wire fraud predicate acts, rather than "securities fraud," growing out of a securities transaction. Thus, despite that fact that "[o]ver the years, courts have paid close attention to matters such as standing, culpability, causation, reliance and materiality, as well as the definitions of 'securities' and 'fraud,'" id.,

the broad swath that the civil RICO's fraud provisions cut through established legal principles makes all of this carefully fashioned law "now an endangered species" Id.

The Senate added securities fraud, as well as wire and mail fraud, to the bill's list of predicates at the suggestion of the SEC's Division of Enforcement because organized crime figures had begun to engage in market manipulation and securities theft. The SEC officials recommended the changes when they understood that the legislation would provide only for government, not private, remedies. They believed that RICO could serve as an important weapon for government enforcement against those activities. See ABA Civil RICO Task Report at 99-100 n.130. When the House added the private civil remedy, no one suggested that the securities fraud predicate was intended to displace the specific statutory scheme long in place.

Moreover, when Congress decided to add securities fraud as a RICO predicate, it referred to only one significant kind of misconduct that was not already covered by the federal securities laws but was attracting organized crime: trafficking in stolen or counterfeit securities. Experience has shown, however, that civil RICO is not being used against schemes of that type. By including the securities fraud predicates, RICO instead allows private claimants to duplicate -- but for treble damages -- the rights already granted by the federal securities laws or allows them to circumvent the limitations that Congress has deliberately fashioned for civil suits under

those laws. In neither type of situation is there any justification for tolerating the costly mischief that civil RICO permits.

E. The Supreme Court Has Held That
Congress, Not the Courts, Must
Correct Civil RICO'S Overbreadth

Up until recently, several trial judges and one federal circuit attempted to restrain the use of civil RICO in ordinary commercial disputes. Some tried to treat the statute as requiring an allegation of some actual connection with "organized crime." E.g., American Savings Ass'n v. Sierra Federal Savings & Loan Ass'n, 586 F. Supp. 888 (D. Colo. 1984). Others tried to require a showing of some special "racketeering injuries." E.g., Harper v. New Japan Securities International Inc., 545 F. Supp. 1002 (C.D. Cal. 1982). These efforts generally met with hostility in most appellate courts. See, e.g., Moss v. Morgan Stanley Inc., 719 F.2d 5, 21 (2d Cir. 1983), cert. denied, 104 S. Ct. 1280 (1984) (rejecting requirement of link to "organized crime"); Sutliff, Inc. v. Donovan Cos., 727 F.2d 648, 654 (7th Cir. 1984) (same); Alcorn County v. U.S. Interstate Supplies, Inc., 731 F.2d 1160 (5th Cir. 1984) (same); Schacht v. Brown, 711 F.2d 1343 (7th Cir.), cert. denied, 104 S. Ct. 508, 509 (1983) (rejecting special injury requirement); Alexander Grant & Co. v. Tiffany Industries, Inc., 742 F.2d 408, 413 (8th Cir. 1984) (same).

This past term, the Supreme Court dashed whatever faint hope had existed that judicial construction of the statute could tame runaway civil RICO. In a 5-4 vote, the Court overturned a decision of the Second Circuit in which the court of appeals had held that a civil RICO claim could only be brought against a defendant who had been convicted of the predicate acts underlying the RICO claim or of RICO itself and could only be brought to collect damages for a separate "racketeering injury," wholly distinct from injury arising from the predicate acts themselves. Sedima, supra. At the same time, the Court affirmed a Seventh Circuit decision in which the lower court had rejected the requirement of a separate injury. American National Bank v. Haroco, Inc., ___ U.S. ___, 53 U.S.L.W. 5067 (July 1, 1985) (per curiam). In deciding these cases, the Court made it crystal clear that any correction in the course civil RICO has taken must come from Congress, not the courts.

The Court was unanimous in recognizing that civil RICO had strayed far from the object that Congress had in mind when it wrote and passed the Act. The majority opinion in Sedima acknowledged that it understood the "concern over the consequences of an unbridled reading of the statute," and the Second Circuit's perception of "misuse of civil RICO." 53 U.S.L.W. at 5034. The majority opinion also recognized that, "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors," id. at 5039, and that "private civil actions

under the statute are being brought almost solely against" what the Court called "respected and legitimate enterprises," rather than against "the archetypal, intimidating mobster." Id. And the majority cited with approval the statistics from the ABA Task Force Report, see pp. 14-15, supra, that bear out that conclusion. 53 U.S.L.W. at 5039 n.16.

As the quotations throughout this Appendix suggest, Justice Marshall, writing in dissent for four members of the Court, was even more explicit in detailing the ways in which civil RICO claims have caused disruptions far beyond anything intended by Congress, but the majority did not disagree with the dissenters' descriptions. Justice Marshall detailed the ways that "in both theory and practice, civil RICO has brought profound changes to our legal landscape," id. at 5041, and he recognized that "nothing in the language of the statute or the legislative history suggests that Congress intended either the federalization of state common law or the displacement of existing federal remedy." Id. Justice Marshall's opinion summarized the problematic results of civil RICO:

"These cases take their toll; their results distort the market by saddling legitimate businesses with uncalled-for punitive bills and undeserved labels. To allow punitive actions and significant damages for injury beyond that which the statute was intended to target is to achieve nothing the statute sought to achieve, and ironically to injure many of those lawful businesses that the statute sought to protect." Id. at 5045.

Justice Marshall as a general matter is neither a strident supporter of states' rights nor an advocate of business

interests against the injured individual; yet he concluded in no uncertain terms that civil RICO has unintentionally altered the balance between federal and state law in a profound manner and has made legitimate businesses a target of "uncalled-for punitive bills and undeserved labels." Id. at 5045.

Justice Powell, who joined in Justice Marshall's opinion, also wrote separately, reiterating the manner in which civil RICO has come to be used "against legitimate businesses seeking treble damages in ordinary fraud and contract cases," and concluding that "it defies rational belief, particularly in light of the legislative history, that Congress intended this far-reaching result." Id. at 5047.

The majority and minority parted company only over the question of whether the courts could play any role in narrowing civil RICO's reach. The minority believed that the language of the statute could plausibly be interpreted narrowly in certain respects. The majority, applying its philosophical belief that the courts should not rewrite statutes, accepted the premise that the statute is being used in unintended ways but rejected the notion that the Court could play any role in solving that dilemma. The majority placed responsibility for solving the problem upon the representative body that passed the statute in the first place: "[T]his defect -- if defect it is -- is inherent in the

statute as written, and its correction must lie with Congress."
Id. at 5039 (emphasis added).

F. Civil RICO Claims Against
 Legitimate Businesses Are Burgeoning

It is likely that, in the face of the Supreme Court's rejection of the major judicial attempts to construe civil RICO narrowly and its deferral to Congress to correct the overbreadth, RICO suits simply alleging securities fraud, commercial fraud, or other "imaginative" claims will continue to grow. The situation is already out of hand and likely to get worse.

Relatively few private RICO cases have progressed all the way to judgment, because intensive use of the statute in civil cases only began to blossom a few years ago. The ABA RICO Task Force Report found that, although the statute was enacted in 1970, there was only one reported opinion in a civil RICO case as of 1972, only one other case reported prior to 1975, and only nine reported decisions prior to 1980. ABA RICO Task Force Report at 55. Since then, the numbers have grown exponentially. Id. See also p. 14 n.2, supra. The invocation of RICO against legitimate businesses in kinds of disputes never contemplated by Congress when it passed RICO is almost certain to accelerate in the wake of the recent Supreme Court decisions, since the Court has eliminated almost any chance that previously existed that a defendant could defeat a RICO claim at the threshold of litigation. Reflecting this impact, the Washington Post headlined its article on the Sedima

decision: "RULING SEEN INCREASING OUT-OF-COURT SETTLEMENTS: More Costly Litigation Also Predicted." Abramowitz, Washington Post, July 2 1985, at E10.

In addition, there is rapidly spreading publicity about the utility of RICO as a device for getting a local commercial dispute into federal court or as a tactic for dramatically increasing the stakes in a case otherwise covered by the traditional single-damage remedy of other, specific federal laws, such as the securities laws. The Washington Post story on Sedima quoted a leading plaintiff's attorney who predicted that civil RICO would be used increasingly in the future to "federalize" product liability litigation. Id. The same day, the Wall Street Journal also commented that civil RICO suits, "few of which involve organized crime, are proliferating because they can be quite lucrative." Wermeil, "Supreme Court Refuses to Curb Racketeer Law," Wall Street Journal, July 2, 1985, at 2. The article summarized the lure: "Plaintiffs favor RICO because of the chance to triple damages and win attorneys' fees and legal costs, and because it poses fewer procedural hurdles than federal securities law or state contract law." Id. As another article discussing the wider use of civil RICO expected in the wake of the Supreme Court's decision put it in its headline: "'Sedima': The Civil RICO's Juggernaut Steams On." Mathews and Weissman, Legal Times (ABA Daily Ed.), July 9, 1985, at 10.

Legal and business journals are filled with articles discussing the statute. See, e.g., Blakey, "RICO Is Working," The Brief (the magazine published by the Tort and Insurance Practice Section of the American Bar Association), Summer 1985, at 18; Quinn and Bograd, "RICO Is Backfiring," id. at 19; Pickholz, "The Firestorm Over Civil RICO," 71 ABA Journal 79 (1985); Skinner and Tone, "Recent Developments in RICO Litigation," National Law Journal, February 13, 1984, at 20; Skinner and Tone, "Civil RICO and the Corporate Defendant," National Law Journal, January 30, 1984, at 22; Flaherty, "Private RICO Damages Awarded," National Law Journal, December 26, 1983, at 8; Sylvester, "Civil RICO's New Punch," National Law Journal, February 7, 1983, at 1; Weissmann, "'Moss' Makes RICO Statute the Darling of Plaintiffs' Bar," Legal Times, December 19, 1983, at 24; Murphy, "RICO -- A Federal Treble Damage Fraud Statute?", New York State Bar Journal, July 1983, at 18; "Business is Picking Up An Anticrime Weapon," Business Week, February 20, 1984, at 85.

So too, law reviews are focusing a great deal of attention on the statute, debating the extent of its flaws and the proper methods of correcting them. See, e.g., Civil RICO Symposium, 21 Cal. W. L. Rev. No. 2 (1985); Comment, Sedima v. Imrex: Civil Immunity for Unprosecuted RICO Violations?, 85 Colum. L. Rev. 419 (1985); Note, Civil RICO: A Call For A Uniform Statute of Limitations, 13 Fordham Urban L.J. 205 (1984); Sackheim, Leto & Friedman, Commodities Litigation: The Impact of RICO, 34 DePaul L. Rev. 23 (1984);

Tyson & August, The Williams Act After RICO: Has The Balance Tipped In Favor Of Incumbent Management, 35 Hastings L.J. 53 (1983); Note, RICO and Securities Fraud: A Workable Limitation, 83 Colum. L. Rev. 1513 (1983); Note, Civil RICO: The Temptation and Impropriety of Judicial Restriction, 95 Harv. L. Rev. 1101 (1982); Campbell, Civil RICO Actions in Commercial Litigation, 36 Sw. L.J. 925 (1982). One recently published bibliography listed approximately 150 articles on civil RICO that have appeared in legal publications. See Milner, A Civil RICO Bibliography, 21 Cal. W.L. Rev. 409, 427-35 (1985).

Numerous how-to-do-it courses are being offered nationwide to acquaint lawyers with RICO's possibilities. For example, the ABA already has held four "continuing legal education" National Institutes on RICO, three in New York City in September 1983, February 1984 and October 1984, and one in Los Angeles in November 1983. With ominous accuracy the ABA titled the first three of these sessions "RICO: The Ultimate Weapon in Business and Commercial Litigation." The latest session, in New York, was entitled "RICO -- The Second Stage." Among the featured topics at the October 1984 meeting were discussions of RICO and its impact on states and municipalities, RICO suits by and against unions, and RICO suits against financial institutions. The popularity of the presentations is great; the mailing for the February 1984 course pointed out that the two earlier meetings were sold out, with over 600 lawyers in attendance. Moreover, one of the programs held at the ABA's August 1984 annual convention was entitled "RICO:

The Current Status of Baby Huey," and at its most recent convention just completed in July 1985, the ABA again had a major program on current developments in civil RICO.

The Practicing Law Institute ("PLI") also held RICO sessions in June of 1984 both in New York City and in San Francisco, with topics including the use of RICO in "antitrust cases," "commercial bribery and faithless employee cases," "unfair competition cases," "securities and commodities cases," and "corporate takeover cases." In addition, Law & Business, Inc., offered RICO programs in Chicago in June and in San Francisco in July of last year and plans similar programs in New York, San Francisco, and Chicago in September, October, and November 1985, respectively.

The volume of RICO litigation is expected to be so heavy that a special reporting service called the "RICO Litigation Reporter" -- now renamed the "RICO Law Reporter" -- began regular publication in May 1984, and two additional reporting services devoted exclusively to this subject recently began publishing. The recent Supreme Court decisions, with the attendant publicity as well as the substantive message contained in those decisions that it is all right to use civil RICO broadly, will only increase the spotlight on civil RICO's potential uses as a weapon in commercial litigation.

The bonanza for lawyers in RICO cases is widely and candidly recognized. Indeed, when the Los Angeles Times did a series of articles last year on "the litigation explosion," it devoted a front page article just to private civil

RICO suits, entitling the feature, "'RICO' Running Amok in the Board Rooms," and subtitling the piece, "Law aimed at Mafia becomes popular in private suits." Siegel, Los Angeles Times, February 15, 1984. The article quoted one RICO lawyer as explaining that when he set up his private law practice he "was looking for a way to develop business," and he "studied RICO and saw the potential for lots of civil litigation." As the Supreme Court recognized, as long as the statute remains worded broadly, lawyers will have every incentive to continue pushing its use to the outer limits of the statutory language. As one author counseled:

"[A] plaintiff's attorney zealously protecting the rights of his client, as he is charged to do, is obligated to bring RICO claims where they can reasonably be interposed." Brodsky, "RICO," New York Law Journal, February 15, 1984, at p. 1, Col. 1.

Of course, in addition to multiple damages, the plaintiffs in these actions seek attorney's fees. While there are few civil RICO cases that have progressed far enough to have reached the fee-determination stage, the amounts at issue are substantial.^{13/} Awards of hundreds of thousands or even millions of dollars are not uncommon under other statutes that contain similar "fee shifting" provisions. The prospect of

^{13/} For example, in Schacht v. Brown, supra, the lead counsel for the plaintiff Insurance Commissioner reported billings of \$363,737.00 through September of 1982. "Insurance Liquidations a Legal Bonanza," Chicago Tribune, September 12, 1982, § 5 at 1. This may include expenses for some items in addition to the Schacht litigation itself, but the vast majority is almost certainly for that civil RICO action, in a period before any significant discovery had commenced.

such handsome awards is a powerful stimulus to press RICO to even newer frontiers.

V. REFORM OF CIVIL "RICO" SHOULD REINTRODUCE THE IMPORTANT OVERSIGHT BY FEDERAL AND STATE PUBLIC PROSECUTORS BY CREATING A PRIOR-CRIMINAL-CONVICTION REQUIREMENT

A. The Administration, The Courts, And Others Have Recognized The Need For Reform

The explosion of unjustified civil RICO cases is already at hand, and the adverse effects of this development on the courts and on legitimate business are direct, palpable, and unwarranted. It would be difficult to overstate the in terrorem effect of civil RICO on legitimate businesses, even though relatively few companies, so far, actually have been ordered to pay treble damages in these cases. As Business Week reported:

"Lawyers say the number of court awards under RICO is not an accurate measure of the problem, because few cases go to trial: The mere threat of a headline suggesting a connection with organized crime often induces a settlement." February 20, 1984, at 85.

In addition, the scope of the permissible allegations permits wide-ranging pre-trial discovery: "That gets very, very expensive," one securities lawyer was quoted as explaining, "and the cost tends to result in settlements." Id. As Justice Marshall himself recognized, a "defendant, facing a tremendous financial exposure in addition to the threat of being labelled a 'racketeer,' will have a strong interest in settling the dispute," 53 U.S.L.W. at 5041, "even a case with no merit." Id.

In urging reform, the American Bar Association has stated:

"When RICO is combined with mail fraud predicate offenses, the effect is to federalize all torts involving business transactions in which a party thinks deceitfully and uses the mails. This result is undesirable in two respects: (1) the efficient operation of federal courts will be significantly impaired, if not crippled, by a tidal wave of RICO civil actions when plaintiffs become aware of the attractions of treble damages and recovery of attorney's fees; and (2) the balance between state and federal power will be substantially disrupted. If future RICO statutes are to include civil remedies, use of mail fraud as a predicate offense must be limited." Reports with Recommendations to the House of Delegates, ABA, 1982 Annual Meeting, August 1982, Report No. 112C at 8, adopted by the House of Delegates August 1982.

According to the recent ABA RICO Task Force Report, fully 74% of all lawyers surveyed with actual experience with RICO claims, either as counsel for plaintiffs or for defendants, believe that the statute should be amended, and only 8% see no need for reform. ABA RICO Task Force Report at 62.

From his unique vantage point as a regulator of the securities industry and the accounting profession, SEC Commissioner Charles L. Marinaccio expressed his view that civil RICO has "gone awry in the execution," and is being used against "the very legitimate corporations and businesses that were intended to be protected" to undermine the "carefully crafted structures" of express and implied remedies under state and federal securities laws. See Statement of Charles L. Marinaccio, Member of the Securities and Exchange Commission, Before the Committee on The Judiciary, United States Senate, May 20,

1985, Exhibit 3. As the Commissioner told this Committee in testimony in May of this year, "I believe there is an urgent need to amend RICO by legislation to end the excessive uses to which the statute's private civil remedy has been put." Id. at 1. The Commissioner recounted the ways in which private civil RICO is "threatening to disrupt the balance of the [federal securities] regulatory scheme," id. at 6, and he concluded that "predicating the availability of a private remedy on prior criminal convictions offers the most reasonable way to mitigate problems in the securities fraud area." Id. at 8. The Chairman of the SEC, John S.R. Shad, has also expressed concern about the unintended impact of civil RICO on "the carefully crafted scheme of express and implied remedies for securities law violations which the Congress and the courts have fashioned over the past 50 years." Id. Exh. 2.

Federal judges, acting in their capacity as commentators on what they are witnessing, also have spoken out in public about the problem. Thus, District Judge Milton Pollack of New York has said:

"[O]ne of the proliferating developments in civil litigation has been the use of RICO, the Racketeer Influenced and [Corrupt] Organizations Act, in civil claims, in routine commercial disputes, including those arising under the Federal Securities Laws. I think that the proliferation of those claims and the use of a law that was designed to eliminate organized crime is a very bad influence on the commercial community." "Symposium Highlighting Developments in Securities Law Over Past Century," New York Law Journal, January 30, 1984, at 52.

And Judge Abner Mikva of the United States Court of Appeals in the District of Columbia, who had warned against the overbreadth of the proposed RICO bill when he was in Congress in 1970, has seen RICO outstrip his worst fears. He warned then that placing a treble-damage remedy under so broadly worded a statute would provide an "invitation" to the "disgruntled and malicious" to "harass innocent businessmen" H. R. Rep. No. 1549, 91st Cong., 2d Sess., reprinted in 1970 U.S. Code Cong. & Ad. News 4007, 4083. As he predicted, "What a protracted, expensive trial may not succeed in doing, the adverse publicity may well accomplish -- destruction of the rival's business." Id. Judge Mikva was quoted in an interview as expressing regret that these problems were not avoided by complete deletion of the civil provision, which "was not an important element of the legislation." Los Angeles Times, February 15, 1984.

In their formal opinions as well, many courts, as the Supreme Court did in Sedima, have warned about these dangers and abuses, even while deciding that they are obliged to apply the expansive language of the statute as originally written. For example, in allowing a mail fraud allegation to proceed as a RICO case, the Seventh Circuit in Schacht ruefully observed that Congress inadvertently "may well have created a runaway treble damage bonanza for the already excessively litigious." Schacht v. Brown, supra, 711 F.2d at 1361. In another Seventh Circuit case, the court observed that RICO "is constructed on the model of a treasure hunt," Sutliff,

Inc. v. Donovan Cos., supra, 727 F.2d at 652, and went out of its way to comment:

"We must abide by Congress's decision, made at a time of less sensitivity than today to the workload pressures on the federal courts and to the desirability of maintaining a reasonable balance between state and federal courts, however much we may regret not only the burdens that the decision has cast on the federal courts but also the displacement of state tort law into the federal courts that it has brought about." Id. at 654.

The Administration has heard these calls for reform and has decided that they are well founded. The Vice President's Task Group on Regulation of Financial Services, whose members included the Attorney General, recognized in its final report adopted on July 2, 1984, that civil RICO is being abused. The Task Group found that:

"[A] statute designed to control organized crime through both criminal and civil penalties against racketeering . . . has increasingly been utilized by imaginative lawyers in suits against banks, securities firms, accountants and other perfectly legitimate businesses without even any alleged connection to organized crime."

The Report continued:

"This litigation increases the backlog in federal courts, undermines the structure of the substantive banking and securities laws enacted by Congress, and creates totally unnecessary costs for the affected firms and, ultimately, their customers."

Accordingly, one of the Task Group's recommendations (number 5.15) calls for "Elimination of Nuisance Litigation Under RICO." Without defining precisely how RICO should be amended, the Task Group states as the Administration's goal the formulation of amendments "to ensure that its civil liability provisions are

not misused by private parties in litigation involving financial institutions."

Attorney General Meese expressed similar concerns during his nomination hearing before this very Committee. In response to a question from Senator Grassley about RICO, Mr. Meese stated:

"I share with you your concern that what is essentially a form of action against criminal activity, even though with civil penalties and civil actions involved -- that this not be misused as a means of carrying on ordinary civil litigation where no organized crime is involved." Transcript of Proceedings (Jan. 30, 1985) at 13.

- B. The Justice Department's RICO Guidelines Apply The Prosecutorial Discretion Envisioned By Congress, And Absent From Private Actions, That Prevents Abuse Of RICO

In 1981, the Criminal Division of the United States Department of Justice promulgated "Guidelines" for the exercise of the Department's power to initiate criminal prosecutions under RICO. See U.S. Department of Justice, United States Attorneys' Manual, §§ 9-110.200 - 110.500 (March 9, 1984). The Guidelines were promulgated because the Department recognized the great possibility for abuse if RICO is applied to every set of circumstances that may conceivably be covered by the broad statutory language. These Guidelines in effect formalize the exercise of prosecutorial discretion that Congress envisioned when it wrote this broadly worded statute.

In their "Preface," the Guidelines state that, despite the statutory provision that RICO is to be "liberally construed to effectuate its remedial purpose," it is the

policy of the Department of Justice that RICO should only be used "selectively." The Guidelines are designed to assure "that not every case, in which technically the elements of a RICO violation exists, will result in the approval of a RICO charge." The Justice Department will not "approve 'imaginative' prosecutions under RICO which are far afield from the Congressional purpose of the RICO statute." As the Guidelines recognize, "the activity which Congress most directly addressed -- the infiltration of organized crime in the nation's economy" -- is the touchstone for determining whether a RICO charge is warranted.

Moreover, the overall theme of the Guidelines, as stated in their Preface, is that "the consequences for the accused" require "particularly careful and reasoned application" of RICO's purposes before making the decision to charge a RICO violation. Accordingly, the Guidelines insist on careful monitoring and centralized control over the Government's filing of any RICO charge. This centralized monitoring guarantees that the Guidelines will be effectively enforced by officials who are charged with public accountability. In dramatic contrast, the decision whether to file a private RICO claim under the broadly worded statute is currently left wholly to the discretion of entrepreneurial private lawyers. Their sole loyalty is to their private clients, and they have no public responsibility for the consequences of any extravagant allegations.

The Justice Department Guidelines highlight another problem with civil RICO as it currently stands. The Preface states that the Department ordinarily will not add a RICO charge "which merely duplicates the elements of proof of a traditional" statute that specifically covers the conduct in question. One of the major criticisms of the current civil RICO provision, however, is that it creates a general, private federal claim for treble damages even where federal law already provides a carefully crafted set of prohibitions and remedies.

The Justice Department's Guideline III expressly directs that, except in extraordinary circumstances, a RICO count will not be asserted "where the predicate acts consist solely and only of state offenses." Reflecting important considerations of federalism, the commentary explains that this guideline is designed "to underscore the principle that prosecution of state crimes . . . is primarily the responsibility of state authority."

Similar observations apply to the use of the federal courts to litigate civil disputes governed by state law. Nevertheless, the inclusion of "mail fraud" and "wire fraud" in RICO has been used by private plaintiffs as a device for bringing into federal courts what are essentially local commercial or property disputes. This use of RICO has "federalized" state commercial and tort cases.

The statute suggests that any two occurrences of a predicate violation within ten years may be sufficient to show a "pattern of racketeering activity." Guideline IV recognizes

that this definition is subject to abuse and provides that no RICO count will be charged "based upon a pattern of racketeering activity growing out of a single criminal episode or transaction."

Most of the private civil cases that have been filed under RICO, by contrast, relate to allegedly fraudulent activity in connection with a single episode or transaction, such as the sale of stock in a single company or the structuring of a particular venture that includes a number of parties. Since each mailing of, for example, a copy of an allegedly misleading financial statement constitutes a separate violation, it is easy for the artful pleader to allege a "pattern" of racketeering in connection with a single commercial episode or transaction. This usage, however, has little to do with the congressional goal of cracking down on racketeers who make their living by engaging in a continuous pattern of illicit activity over a long career.

In addition, Guideline V states that, in order to constitute a violation of RICO, the "pattern of racketeering activity" should have "some relation to the purpose of the enterprise." This sensible interpretation is not followed in the civil cases that have been filed under RICO, where allegedly fraudulent activities conducted by legitimate businesses such as investment banking houses, brokerage firms, accounting firms, law firms, and others are -- even if true -- aberrational rather than related to the purpose of those "enterprises."

Many of the concerns reflected in the Justice Department Guidelines, thus, apply with equal force to private civil litigation under RICO. These internal Guidelines, however, do not regulate the activity of private plaintiffs. Therefore, legislation is necessary in order to erect similar safeguards around the private civil RICO mechanism and in that way to minimize its great potential for abuse.

C. A Prior-Criminal-Conviction Requirement
Is The Most Straight-Forward And Workable
Solution To The Current Abuse Of Civil RICO

There is one straight-forward amendment to civil RICO that would eliminate the existing abuses, refocus the statute on its intended targets, and adapt the Justice Department's Guidelines to the civil use of RICO. That would be to permit civil claims to proceed under RICO only after the defendant has been convicted of a RICO offense or of one of the predicate offenses. This amendment would effectively curb the abuse of the discretionary power to bring private claims against legitimate business people involved in ordinary commercial activities. It would confine the circumstances in which suits can be filed to those in which public prosecutors have screened those people who may fairly be charged with being involved in crimes from those who should not be subject to accusations of "racketeering". This is the kind of protection that a panel of the Second Circuit read into RICO in the Sedima case and that SEC Commissioner Marinaccio called upon Congress to write into the statute.

The American Bar Association's Special Task Force on Civil RICO also recognized that a prior criminal conviction requirement would eliminate the abuse of civil RICO and restore the statute to the purpose Congress originally intended:

"Requiring a criminal conviction as a predicate to civil treble damage liability under RICO would alleviate virtually all the problems critics have posed concerning overbreadth of the civil remedy."
ABA RICO Task Force Report at 222.

What is needed is legislation that will amend 18 U.S.C. § 1964(c) so that a private civil plaintiff could only bring suit against a defendant who has been convicted either of one of the predicate acts or of a RICO violation itself. In either case, the conviction would have to be for the conduct upon which the private suit is based. (We attach as Exhibit A to this Appendix proposed language to accomplish this result. The suggested amendment would also set a statute of limitations of one year, measured from the latest judgment of conviction for RICO or the civil predicate acts upon which the civil action is based. This proposal is identical to H.R. 2943, introduced on July 10, 1985, by Representative Boucher.)

Under this amendment, civil RICO could no longer be used simply to raise the stakes in or federalize commercial disputes. The plaintiff would have to prove that:

- (1) the defendant violated the provisions of RICO by engaging in conduct that violated 18 U.S.C. § 1962;

- (2) the defendant has been convicted either of a RICO violation or of one of the predicate acts based on the conduct upon which the plaintiff bases his civil RICO claim;
- (3) the plaintiff has been injured in his business or property by the defendant's violation of Section 1962; and
- (4) the plaintiff has filed his treble-damage suit within one year of the latest pertinent convictions.

With this change in the law, civil RICO could only be used against persons whom prosecutors have decided to charge with crimes and who have been found guilty of criminal acts. This amendment would restore the central role of public prosecutors originally envisioned by Congress. Before plaintiffs could call upon the treble-damage remedy made available under RICO specifically to deal with organized crime, there would first have to be a determination by the public prosecutors and juries that the defendant was actually engaged in criminal activity.

The ABA RICO Task Force Report agrees that the creation of some prior criminal conviction requirement "would be preferable to the present statute and its intolerable overbreadth." ABA RICO Task Force Report at 238. Nevertheless, instead of this direct and precise solution, the ABA Task Force offers as an alternative a package of ten different substantive changes in the statute in order to achieve the same basic result as the prior criminal conviction requirement -- returning civil RICO to its proper focus. That laundry

list of changes, however, is cumbersome. It is likely to raise complex problems in the course of drafting and implementation. In fact, the drafting issues were so unwieldy that the Task Force did not even attempt to offer specific statutory language to implement its proposals.

Furthermore, most changes in statutory language, no matter how minor, raise issues of interpretation and implementation unanticipated at the time of passage. An approach that requires ten major changes is certain to create many new issues. The prior criminal conviction requirement achieves the same result with but one simple amendment. It has already been drafted and its impact has been subjected to intense scrutiny and conjecture by its proponents and opponents alike. As the following discussion demonstrates, despite that intense scrutiny, no major problems that would arise from its implementation have been identified.

The ABA RICO Task Force alternatively suggests that if some version of a prior criminal conviction requirement is adopted, the Congress should consider making treble damages available only where there are prior criminal convictions, but allow private plaintiffs to sue for actual damages even where there have been no previous convictions. ABA RICO Task Force Report at 238. Such a change would, of course, not solve the underlying problem, which is the use of civil RICO for unintended and abusive purposes. Two major opportunities to abuse civil RICO would remain. First, plaintiffs would still be able to increase the in terrorem effect of their

suits -- and hence their settlement value, whatever the merits of the cases -- because of the coercive effect of even an unsubstantiated accusation of "racketeering." Second, plaintiffs would be able to "federalize" traditional state law tort and contract claims by recasting them as RICO cases, and thus accelerate the growth of cases on the federal court dockets that rightfully belong in the state legal systems, if anywhere. Thus, all civil RICO claims should be subject to a prior conviction requirement.

D. None Of The Criticisms Of A Prior Criminal Conviction Requirement Is Substantial

Persons eager to preserve the potent weapon which civil RICO has become in ordinary commercial litigation have repeatedly thrown out a laundry list of so-called problems associated with a prior-criminal-conviction requirement. Through repetition -- and undoubtedly because to date these claims have generally gone unanswered -- these assertions have taken on more credence than they deserve, and we find less jaundiced observers, such as the ABA RICO Task Force and the five-Justice majority of the Supreme Court in Sedima, repeating these criticisms. In truth, if these so-called problems are examined one by one, one discovers that there is no real substantial impediments behind the rhetoric.^{14/}

^{14/}The proof, in part, is in the doing. We discussed earlier cases in which plaintiffs brought civil RICO cases against defendants who had first been convicted on criminal charges. See pp. 16-17, supra. There is no indication in any of these cases that the plaintiffs found insurmountable problems or even substantial difficulties in bringing those lawsuits.

1. "Gutting" the civil remedies

A criminal conviction precondition to private civil RICO actions would not "gut" the remedies available to private parties, as some critics of a prior-criminal-conviction requirement charge. As our earlier discussion demonstrates, there already have been cases in which plaintiffs have used civil RICO to go after defendants who had been first convicted of criminal charges. See pp. 16-17, supra. Cases of this type would continue. Moreover, if there has been no criminal prosecution and conviction, a potential plaintiff would still have available all the other federal and state law remedies that apply to commercial disputes and torts; he would not be left without a remedy.

2. The "private attorney general" rationale

The ABA Task Force suggests that the criminal conviction requirement may be "too restrictive" because it would eliminate "what some courts have labelled the useful 'private attorney general' aspect of Civil RICO." ABA RICO Task Force Report at 238. The Supreme Court majority in Sedima similarly referred to Section 1964(c) as a "private attorney general" provision[.]" 53 U.S.L.W. at 5038. This view, however, rests on the erroneous assumption that civil RICO was meant to deputize private claimants and their lawyers to serve as "private attorneys general." The private damage remedy under RICO, however, was not created in order to empower private citizens to take on law enforcement responsibilities, and

there is no good reason to view the statute today as serving that end.

No one who has taken a hard look at the problem of organized crime -- not the Kefauver Committee in the 1950s, not the Katzbach Commission in the 1960s, not Senator McClellan's Committee in the 1960s and 1970s -- has ever believed that private civil suits could be an important weapon in the war against organized crime. Significantly, the Department of Justice itself has never suggested that it believes that private citizens should have the right to accuse other persons of crimes, nor has the Justice Department indicated that private suits are necessary to supplement its efforts to attack organized crime.

Indeed, it would be foolish to believe that a private citizen would have the temerity to sue a real organized crime figure for racketeering, unless the government has first prosecuted and convicted him. There is no indication that anyone in Congress entertained that naive belief when RICO was passed in 1970. The lesson of the last 15 years' experience with civil RICO confirms the sensible assumption that criminal conviction is, as a practical matter, a necessary precondition to private RICO suits against the kind of criminal Congress had in its sights. In the few civil RICO cases that have been brought against violent organized crime figures, private suits actually have followed prosecution and conviction, and have not been a substitute for criminal conviction. See pp. 16-17, supra.

Thus, the only impact from adopting a criminal conviction requirement would be to filter out the suits that have nothing to do with the war on organized crime.

Moreover, Assistant Attorney General Trott's testimony before this Committee in May 1985 shows that the Justice Department has brought RICO prosecutions in at least as many cases as civil litigants are using the statute, and the number of federal criminal cases is growing. Federal and state prosecutors, of course, bring thousands of non-RICO prosecutions involving the predicate offenses listed in RICO. It is baseless to assert that the targets of the private civil RICO cases that private lawyers have brought in the absence of prior convictions would have been prosecuted if only federal and state prosecutors had more resources. The simple truth is, as the Executive Director of the ABA RICO Task Force acknowledged elsewhere, these private civil suits are brought in cases that no responsible prosecutor would have treated as criminal. See pp. 17-18, supra.

3. Possible effects on public prosecutors

The opponents of the prior-criminal-conviction requirement assert that this requirement could influence the way public prosecutors perform their duties. They speculate:

- (1) Federal prosecutors could be subject to undue pressures from private parties with potential civil RICO claims to press RICO-related prosecutions.
- (2) Prosecutors may be subject to accusations that they were influenced in their decisions to press RICO-related prosecutions because of the impact on individuals' civil remedies.

- (3) Prosecutors may be willing to accept plea bargains that are unrelated to the merits of the case. The criminal conviction requirement, it is suggested, could create a powerful new weapon in the hands of the prosecutor to force defendants to plead to lesser, non-predicate-act offenses. If prosecutors accept pleas to non-predicate act offenses, private litigants would lose their opportunity for civil relief, or at least lose the opportunity to sue certain defendants.

The fact is that public prosecutors already are subject to the entreaties of private parties whose interests are at stake in criminal proceedings. In the full range of potential civil litigation, from murder and arson to securities fraud and antitrust, there are private parties whose ability to win civil damage suits would be vastly enhanced by a successful criminal prosecution. The public prosecutor's duty, however, is to weigh those interests in balance along with other relevant factors in deciding where the public interest lies. There is simply no reason to presume that a RICO statute subject to a prior-criminal-conviction requirement would create pressures qualitatively different from those which already exist, or that the prosecutors would no longer be able to discharge their duties fairly, or that the public perception of the prosecutor's decision-making would be adversely affected.

Nor is there any basis to assume that a federal prosecutor will bargain away a good case against racketeers -- either on the predicate offenses or the RICO charge itself -- and thus foreclose an otherwise proper civil RICO case. Many of the predicate acts listed in the RICO statute do not have

"lesser included offenses," and so it would be difficult, if not impossible, to arrange a plea to a non-predicate offense in an organized crime case. Furthermore, plea bargaining in the federal courts has never been as extensive as in the overcrowded and understaffed state court systems. Federal prosecutors simply do not bargain away good cases because of other constraints, such as limited resources. It is virtually unthinkable that federal prosecutors, despite public and congressional oversight, would irresponsibly agree to drop real organized crime cases in plea bargaining.

The decision to enter a plea bargain in federal court is governed principally by three general considerations: (1) the severity of the crime; (2) the record of the defendant; and (3) the strength of the government's case. The United States Attorneys' Manual, which states the rules and guidelines that govern federal prosecutors, sets out eleven factors that the prosecutor must consider in "determining whether it would be appropriate to enter into a plea agreement." The factors at the top of the list include the "defendant's willingness to cooperate in the investigation or prosecution of others," the defendant's criminal record, the nature of the charges, the defendant's "remorse or contrition," the "likelihood of obtaining a conviction at trial," and similar concerns. Only at the end of this exhaustive list does the manual even mention consideration of prosecutorial and judicial resources. See U.S. Department of Justice, United States Attorneys' Manual

§ 9-27.420 (June 15, 1984). Thus, the Department of Justice's own standards will prevent prosecutors from allowing organized crime figures to escape with pleas to minor crimes.

Finally, as a practical matter, it is doubtful that fear of civil liability would be a major factor in a criminal defendant's decision whether to enter a plea bargain. Moreover, if it did provide an additional incentive to get organized crime figures to plead guilty and to cooperate with the federal authorities, Congress should encourage that result, not fear it. The primary purpose of RICO has always been, and should remain, to increase the weapons available to federal prosecutors in fighting organized crime. If the rare case comes along in which the prosecutor concludes that he can use the threat of a private civil suit to gain cooperation from a racketeer, purely private financial interests should not be allowed to frustrate the public interest in effective criminal law enforcement.

4. Possible effect on witness credibility

Another concern that has been raised is that a witness's credibility would be subject to challenge at a criminal trial if he stands to gain from the conviction of the defendant. Here again, a criminal conviction requirement would not qualitatively change the present situation. Any witness with an actual or potential civil claim against the defendant has a financial and personal stake in the success of the criminal prosecution; thus, the witness's credibility is already

subject to challenge on that basis. Moreover, under modern notions of collateral estoppel, if the defendant is convicted on the charges, the factual issues resolved against the defendant by the verdict would in all likelihood be considered settled against him in a civil suit. See Parklane Hosiery Co. v. Shore, 439 U.S. 322 (1979). Thus, under RICO as well as under other statutes, the benefit accruing to a victim/witness from a conviction in a parallel criminal proceeding already provides a basis for attacking the witness's credibility in the criminal trial.

Indeed, if a criminal conviction is not a precondition to civil suit, the witness may have a civil suit pending concurrently with his testimony in a criminal case. In the jury's eyes, this direct and specific interest in obtaining a conviction may cast more doubt on the witness's credibility than would the mere possibility that the witness might file a civil suit if the defendant is convicted. Thus, by postponing the ability to file a civil RICO suit, Congress could actually minimize questions about the complaining witness's credibility at the criminal trial and thereby enhance the statute's primary purpose, the prosecution and conviction of organized crime figures.

5. Delay in bringing the civil RICO suit

Another category of issues raised about the prior-criminal-conviction requirement involves the timing of civil suits. The comments generally take the following form:

- (1) Uncertainty would exist as to when the statute of limitations begins to run on the RICO claim, and whether the civil plaintiff must wait until criminal appeals are exhausted.
- (2) It is unclear what effect reversals or pleas of nolo contendere would have on civil RICO claims.
- (3) Private parties would be forced to divide causes of action and bring two separate suits, because they have to go forward with their non-RICO claims before the statute of limitations runs out.
- (4) Because of the long interval that can pass between the occurrence of a crime and a conviction, the private plaintiff's ability to pursue a civil remedy successfully could be prejudiced by (a) the staleness of evidence and (b) the defendant's dissipation or concealment of assets.

None of these worries is substantial. There is no difficulty in establishing the beginning of the limitations period. A claim does not accrue for purposes of a statute of limitations until all the elements of the plaintiff's cause of action exist. See, e.g., Impro Products, Inc. v. Block, 722 F.2d 845, 850 (D.C. Cir. 1983), cert. denied, 105 S. Ct. 327 (1984). If a prior criminal conviction constituted a necessary element of a civil RICO claim, the statute of limitations would not begin to run until the government secured the pertinent conviction. In any event, the amendment can include language that specifically links the limitations period to the date of the latest pertinent judgment of conviction, as does H.R. 2943.

The other issues can be handled equally easily under well-established principles of judicial procedure. By analogy

to principles of res judicata and collateral estoppel, which take effect as soon as the trial court enters its judgment, the civil RICO suit could commence as soon as a judgment of conviction is entered and need not wait until appeals have run their course. If one of the predicate convictions is reversed on appeal and remanded for a new trial, the civil action could be stayed during the proceedings on remand, or could be dismissed without prejudice to refileing at a later date if the defendant is re-convicted.

If in the criminal proceeding the defendant pleads nolo contendere or enters the kind of "no contest" plea the Supreme Court approved in North Carolina v. Alford, 400 U.S. 25 (1970), the judgment in either case would lay the foundation for a civil RICO complaint. The law treats either of those pleas as a confession of guilt, and the court renders a judgment of conviction. See id. at 35-37; Lott v. United States, 367 U.S. 421, 426-27 (1961). Once a conviction is entered, the private plaintiff could proceed accordingly with a RICO suit.

Nor is there any problem created because certain related causes of action might accrue before the civil RICO claim accrues. The premise underlying this concern is that the civil RICO remedy duplicates other existing federal or state remedies that the plaintiff may pursue. Since the purpose of creating the civil RICO remedy was to authorize redress for people who otherwise have no legal rights under

- other statutes and legal theories, this is an ironic objection. In cases of that sort, a potential RICO claim should be viewed as merely cumulative. The plaintiff has no legitimate grievance if he must proceed with other remedies that the law already makes available to him.

In any event, if a plaintiff has both a potential RICO claim and a ripe claim under another legal theory, normal rules of procedure would govern. The plaintiff may bring his non-RICO claim on a timely basis. If he wishes to defer further proceedings in that suit until any criminal charges against the defendant are resolved, he may seek to stay his civil suit until the RICO claim ripens. If he proceeds with the non-RICO claim, the established principles of res judicata and collateral estoppel would govern the impact of the outcome of that first action on any later RICO action. See 1B J. Moore, J. Lucas & T. Currier, Moore's Federal Practice ¶¶ 0.441-0.448 (2d ed. 1984). If he loses his non-RICO case claim after a fair opportunity to establish it, he has little reason to complain that this decision would bar an overlapping RICO-related claim based on the same conduct.

If, by contrast, the plaintiff wins a damage award in his non-RICO suit based on the predicate acts, and then brings a proper RICO case, the damage awards may not completely overlap. His RICO claim may relate to a distinct type of injury and, in any event, would be trebled. To the degree that there is duplication, the second court would reduce the later award under established legal principles preventing

duplicative awards for the same injury. See, e.g., American Mail Line, Ltd. v. Weaver, 408 F.2d 674, 675 (9th Cir. 1969).

The concerns expressed about the staleness of evidence also suffer from similar underlying defects. A problem of stale evidence would seldom arise. As previously discussed, under modern notions of offensive collateral estoppel, the criminal conviction would probably establish the defendant's civil liability in the ensuing civil RICO suit, without even the need for further evidence. Moreover, all of the evidence collected through the government's resources and presented at the criminal trial would be available to the civil plaintiff.

In any event, the plaintiff with a civil RICO claim may have to depend, for practical purposes, on a prior criminal proceeding. RICO defines a "pattern of racketeering," which even the civil plaintiff must allege and prove, as at least the commission of two predicate offenses within a ten-year span. Thus, no one may bring a civil RICO claim until the defendant has committed at least a second predicate offense, at which point the first offense may well be quite dated. In the absence of a prior criminal prosecution, a private party could have substantial difficulty proving the earlier predicate offense, especially if it involved an unrelated transaction, as it should. Thus, not only is the "lag time" in government prosecutions unlikely to undermine a plaintiff's ability to prove a proper civil RICO case, prior prosecution

may well be a necessary component of a successful private civil case.^{15/}

The prospect of dissipation of assets is also illusory. Under the 1984 amendments to RICO, Congress gave the government expanded powers to bring forfeiture proceedings in conjunction with criminal charges under RICO and to obtain preliminary relief in the form of seizure of assets even prior to indictment. See Sec. 302, P.L. 98-473, 98 Stat. 2040-44 (amending 18 U.S.C. § 1963). The government, therefore, has both the power and the incentive to prevent the defendant from secreting his assets. Moreover, under the 1984 amendments, the Attorney General is empowered to use the funds actually obtained through criminal forfeiture to "restore forfeited

^{15/} It is true that some civil RICO plaintiffs have manufactured a "pattern" out of essentially simultaneous events, principally because separate acts of mail fraud, wire fraud, or securities fraud can be pleaded for each instance in which the mail or telephone is used or each time a share is sold. See pp. 5-6, supra. But these are instances in which RICO is being abused to apply only to a single episode or transaction.

In cases actually involving organized crime, the predicate acts will be more widely separated in time. The Justice Department recognizes that this separation in time is a characteristic of a proper RICO case; under its RICO guidelines, the Department prohibits use of RICO to challenge conduct that is simply part of a single episode or transaction. U.S. Department of Justice, United States Attorneys' Manual, ¶ 9-110.340 (March 9, 1984); see pp. 48-49, supra. As the Department explicitly states in explaining this limitation, "the purpose of this guideline is to prevent a pattern of racketeering activity being charged which lacks the attributes which Congress had in mind but which is literally within the language of the statute." Id. at ¶ 9-110.341; see also Sedima, 53 U.S.L.W. at 5038 n.14, 5039 (suggesting the statutory requirement of proof of a "pattern" demands something more than just proof of two predicate acts within ten years).

property to victims" of a RICO violation or "take any other action to protect the rights of innocent persons" and "award compensation to persons providing information resulting in a forfeiture" 18 U.S.C. § 1963(h)(1) and (3). Thus, prior criminal proceedings actually may enhance the ability of civil plaintiffs to secure compensation.

Nor should one lose sight of the fact that persons with claims for relief arising from the predicate acts may press those claims immediately. If they have damage claims for securities fraud or commercial fraud, for example, they would not be inhibited from bringing those claims simply because there is a separate limitation designed solely to assure that civil RICO claims deal only with actual criminal conduct. Rule 64 of the Federal Rules of Civil Procedure provides ample remedies to the private plaintiff to assure that the defendant preserves enough assets to satisfy a potential judgment.

6. Inability to reach some of the culprits

Finally, questions have been raised about whether it is sound to prevent private plaintiffs from bringing civil RICO suits against actual criminal offenders who, for some reason not related to their culpability, are not convicted.

We have already touched on one of these situations, where federal prosecutors are able to get one of the suspects to cooperate by allowing him to plea bargain to a non-predicate offense or even by immunizing him from all criminal liability. See, p. 60, supra. Traditionally, prosecutors have had great

difficulty getting such cooperation from organized crime figures, because of the enormous risks faced by the member of organized crime who aids the government. The Department of Justice and Congress, therefore, should embrace, not reject, the opportunity to create a new incentive to get persons to give evidence against organized crime. Moreover, the private party in these hypothetical situations will still have other potential defendants to sue -- those against whom the cooperating culprit testifies. It is also reasonable to assume that it will be the minor figures who are given the opportunity to plea bargain; the major targets, who are likely to have greater assets, will remain exposed to private civil RICO claims.

The other points voiced by opponents fall equally short. They are:

- (1) If the indictment is dismissed for reasons unrelated to the merits, the civil plaintiff will never be able to sue.
- (2) Without changes in the legal concept of derivative liability, if individual principals are convicted of predicate acts, but the organization holding the assets is not, the civil plaintiff will not be able to reach the assets necessary for compensation.
- (3) If the criminal defendant remains a fugitive from justice, the criminal case will remain unresolved and the private plaintiff will go uncompensated even though the fugitive has assets in this country against which a civil award could be collected.

In fact, a fatal dismissal of an indictment for reasons unrelated to the merits occurs only in the rarest of

cases. In virtually all instances in which the indictment is dismissed on technical grounds, the government can simply reindict. Federal law specifically provides for an extension of all statutes of limitations in order to guarantee federal prosecutors just such an opportunity to reindict. See 18 U.S.C. §§ 3288-89.

Opponents of the criminal conviction requirement also conjure up the specter of a serious criminal case that the government cannot successfully prosecute after a court suppresses critical evidence because it was seized in violation of the Fourth Amendment. This is a far-fetched fear. Even before United States v. Leon, ___ U.S. ___, 82 L.Ed.2d 677 (1984), in which the Supreme Court created a substantial exception to the "exclusionary rule" for cases in which the police rely in good faith on a search warrant, the exclusionary rule actually had led to suppression of evidence in a miniscule proportion of all criminal cases. The empirical studies cited by the Supreme Court in the Leon case found that the exclusionary rule affected the prosecution in the cases of only about 1% of the persons arrested for felonies. 82 L.Ed.2d at 688 n.6. Since these figures relate to all persons arrested, the percentage of arrestees who were actually guilty but escaped conviction because of the suppression of evidence must have been even smaller.

Even those figures overstate the effect of the exclusionary rule in organized crime cases, since most challenged

searches and seizures involve street crimes investigated by local police, not carefully planned and supervised federal investigations of organized crime. It will be the careful investigations of organized crime activities, where search warrants are typically used, that will particularly benefit from the Supreme Court's recent decision in Leon to eliminate the exclusion when investigators rely on warrants.

Furthermore, even when the exclusionary rule applies, its scope is extremely limited. The illegally seized evidence may be used against all defendants except the particular person whose Fourth Amendment rights were actually violated. Brown v. United States, 411 U.S. 223 (1973). Thus, the case against all co-conspirators and other defendants accused of participating in the racketeering enterprise would be unaffected. At bottom, then, only in the rarest of cases, if ever, would the Fourth Amendment block conviction on RICO-related charges and deprive an otherwise deserving plaintiff of the opportunity to pursue a civil RICO recovery.

Similarly insubstantial is the speculation that a conviction requirement could insulate from recovery the assets that a convicted racketeer has placed within some unconvicted enterprise. It is quite unlikely that an organized crime figure will place his assets in a business organization that is outside of his personal control. Rather, the enterprise will be operated in a form -- such as a partnership or a joint venture -- where the assets can be reached through a suit

against the individual. Even if the criminal resorts to a corporate form, the assets will still be reachable for at least one of two reasons. The criminal principal will own or control the stock of the corporation, in which case that stock, representing the value of the assets, can be reached. If the criminal does not own the enterprise outright, then he will undoubtedly be milking it or otherwise misusing the corporate form in a manner that will allow the court to "pierce the corporate veil," thus permitting the civil plaintiff to reach the assets at issue. See generally Note, Piercing the Corporate Law Veil: The Alter Ego Doctrine Under Federal Common Law, 95 Harv. L. Rev. 853 (1982). In sum, no criminal is simply going to give away his ill-gotten gains. As long as the assets remain his, the law provides the necessary tools to break through any formal barriers. Thus, the problem supposedly posed by the conviction of the "principals" but not the "organization" is no problem at all.

Similarly, the defendant's fugitive status will rarely, if ever, stand in the way of a civil RICO claim. There are few places left in the world for an indicted criminal to hide. According to the Office of the Legal Adviser at the Department of State, the United States currently has criminal extradition treaties with over one hundred nations, including all of the countries in which a wealthy racketeer might want to take refuge. Moreover, Congress cannot realistically assume that all members of a criminal enterprise will

successfully flee the United States and in that way escape conviction. Only in that extraordinarily unlikely event would a plaintiff be left with no target for a civil RICO suit. Thus, few if any proper civil RICO plaintiffs will be left without any civil recourse against any racketeer.

VI. CONCLUSION

The need for reform is clear. The nature of the reform is clear. And the responsibility for reform is clear. Congress should amend the civil provisions of RICO to focus the private remedy on its original purpose of aiding the war against organized crime, while curing its capacity to bludgeon innocent business people.

The easiest and best method to accomplish this purpose is to amend 18 U.S.C. § 1964(c) to create a prior-criminal-conviction requirement in private civil RICO actions. This type of amendment will give rise to the fewest complications. None of the arguments against this requirement stands up under analysis. The proper civil RICO plaintiff -- the victim who has been damaged by actual criminal activity committed by a repeat criminal offender -- will have a full and effective remedy. The only losers will be those persons who should have no legitimate claim to invoke this special statute at all.

Mr. LEE. The principal basis for the misuse of the statute has been the so-called predicate acts, mail fraud, wire fraud, fraud in the sale of securities. The statistics show that the principal targets of civil RICO are defendants in securities litigation.

Surveys have shown that over 40 percent of all RICO allegations involve cases arising from securities transactions, but there is a terrible irony in the widespread use of civil RICO in securities litigation since RICO provides plaintiffs with a way around 50 years of carefully crafted statutes, regulatory standards, and judicial decisions. As Justice Marshall said in *Sedima*, RICO virtually eliminates decades of legislative and judicial development of private civil remedies under the Federal securities law.

We have a concern about the real practicalities of litigation as distinguished from the words of the statutes and the theory behind them. The same concern for the practicality not the theory means that the single most important issue in evaluating any proposal to reform RICO is whether it provides a clear limitation to the types of suits for which the plaintiffs may invoke the special Federal anti-racketeering statute to claim treble damages. Only such a clear-cut limitation will allow business people, especially professionals, who suffer injury simply from the institution of RICO-type litigation to seek early dismissal of inappropriate cases.

Of grave concern to the accounting profession is the fact that RICO continues to be used to evade the standards of the securities laws and to raise the stakes in ordinary litigation arising from securities transactions.

Today, the Institute remains ready to support the legislation that came too close to passage last year. In fact, the bill pending in the House, which is H.R. 2983, which Representative Boucher introduced with a broad, bipartisan cosponsorship of 11 of his colleagues of the House Judiciary Committee, is very similar to last year's bill, and we support it.

However, S. 1523, the bill pending before this committee, differs from last year's legislation and from H.R. 2983 in one respect that is so critical that the AICPA must oppose that legislation in its present form and urge that it be amended to eliminate the major defect.

That major defect has to do with the small investor definition. The small investor definition actually sweeps in more than 50 percent of the over 45 million investors of securities in the United States.

For the principal targets of civil RICO, because of the small investor feature in S. 1523, it fails to pass the basic criterion for any legislation designed to reform civil RICO. It does not back one iota on the substantive reach of the statute.

Moreover, the most substantial civil RICO cases arise not just in securities—

Senator METZENBAUM. I am going to have to cut you off, Mr. Lee.

Mr. LEE. I will try to wind up, if I may, please.

Senator METZENBAUM. Please do.

Mr. LEE. We are concerned about class action litigation as well. RICO creates the greatest havoc in these cases.

S. 1523 does offer clear, direct, and effective relief from liability for minor segments of RICO defendants, such as business defendant

suits by other businesses. However, for the single largest portion of RICO defendants, those involved in cases arising from securities transactions, the legislation promises to make matters worse.

The simple elimination of the so-called small investor exception would redress the imbalance in the legislation significantly and offer some substantial relief in exchange for some continued exposure. That compromise, we believe, is more than fair and we urge the Committee to amend S. 1523 accordingly.

Thank you, sir.

[Statement follows:]

STATEMENT OF
BERNARD Z. LEE, SENIOR PARTNER, SEIDMAN & SEIDMAN
ON BEHALF OF THE
AMERICAN INSTITUTE
OF CERTIFIED PUBLIC ACCOUNTANTS

Before the

Committee on the Judiciary
of the
United States Senate

October 29, 1987

Introduction

Mr. Chairman, Members of the Committee, I am Bernard Z. Lee. I am a Senior Partner of the accounting firm of Seidman & Seidman, and I am testifying today on behalf of the American Institute of Certified Public Accountants. Accompanying me is AICPA Special Counsel Philip A. Lacovara of the law firm of Hughes Hubbard & Reed.

The AICPA is the national professional organization of certified public accountants, or CPAs, in the United States. This year, the organization is celebrating its one hundredth year of service to the profession and to the public. Today, membership consists of over 250,000 CPAs in public practice, industry, education and government. The Institute is widely recognized as the authoritative voice of the accounting profession.

The RICO Problem

Mr. Chairman, over two years ago, we first appeared before this Committee in search of relief from the onerous civil provisions of the RICO statute. At that time, our organization and others set forth what we believed was a persuasive case for significant reform of the statute. Many people already had recognized that, as the Supreme Court put it in the Sedima decision, "in its private civil version, RICO is

evolving into something quite different from the original concept of its enactors," the members of Congress. We will not repeat here the legislative history of the RICO provisions, which we described in detail in our earlier testimony. For the Committee's convenience, we submit with our testimony today a copy of that earlier testimony. Suffice it to say that Congress intended to create a flexible weapon for use in the war against organized crime, but, at the last minute and without any serious consideration of the consequences, it empowered private persons to bring suit under RICO for treble damages and attorney's fees based upon any transaction that could be pleaded within the statute's broadly-worded provisions.

The principal bases for the misuse of the statute have been the so-called "predicate acts" of mail fraud, wire fraud, and fraud in the sale of securities. Allegations of fraud can be framed easily in almost any business transaction gone awry. And this is exactly what has happened in the RICO arena. The statute can be invoked in every kind of litigation where a disgruntled investor, purchaser, or business associate can possibly allege that another party to the transaction did not deal fairly with him. Under the criminal mail and wire fraud test, this kind of allegation appears to be sufficient to constitute "fraud". From there, it does not take much to construct a treble-damage federal RICO claim.

The main impediment to a RICO claim that has developed in the case law -- the requirement that there be a "pattern" of

such misconduct -- is not likely to present much of an obstacle to the careful attorney. Most commercial, business and professional relationships in the modern world involve a sufficient number of parties, extend over a sufficient period of time, and involve a sufficient number of discrete activities that plaintiffs can meet almost any of the current judicial interpretations of the "pattern" requirement. As the Supreme Court wrote in Sedima, whatever defect in the language of RICO leads to its misuse is "inherent in the statute as written, and its correction must lie with Congress."

The statistics show, moreover, that the principal targets of civil RICO are defendants in securities litigation. Surveys have shown consistently that over 40 percent of all RICO allegations involve cases arising from securities transactions. This should come as no surprise, since broad allegations of fraud have long been part of securities litigation, and well-established members of the plaintiffs' securities bar are among the most sophisticated plaintiffs' attorneys in the nation.

But there is a terrible irony as well in the widespread use of civil RICO in securities litigation, since the federal government has regulated the securities markets directly and extensively for over fifty years. Suddenly, RICO provides plaintiffs with a way around those carefully-crafted statutes and regulatory standards. As Justice Marshall wrote in Sedima, RICO "virtually eliminates decades of legislative

and judicial development of private civil remedies under the federal securities laws."

Finally, it is important to keep in mind, in light of where the debate on civil RICO reform stands today, that the case for civil RICO reform has always been based upon the real practicalities of litigation, not some abstract notion of how the words in a statute should work in theory. Thus, for instance, one must ignore the reality of litigation to give much credence to one of the principal reprises voiced by the opponents of true RICO reform. They claim that defendants have nothing to fear from the RICO statute because, before it imposes liability, a jury must be convinced that the plaintiff has proved all of the elements of a criminal violation of the "predicate acts" (although subject only to a civil standard of proof) and that the plaintiff has met all of RICO's other complex elements, such as the "enterprise" requirement, the "pattern" requirement, and so on.

The reality is that a defendant, particularly a professional whose ability to earn a livelihood is dependent upon his reputation in his community, facing potential liability in the millions of dollars, public accusations of criminality leveled by a private claimant, and the extremely broad, intrusive, and disruptive discovery that accompanies a RICO case, is not going to find much comfort in the possibility that a jury ultimately will be able to sort out the confusing array of standards and elements of a RICO offense and decide to

absolve him. This is particularly true in cases brought on behalf of individual consumers, whose attorneys will attempt to invoke the sympathies of the jury to right the alleged wrong (with the specter of insurance lurking in the backs of everyone's minds), whatever the confusing legal standards might actually dictate.

Once again, Justice Marshall hit the nail on the head when he recognized in Sedima that "many a prudent defendant, facing ruinous exposure, will decide to settle even a case with no merit. It is thus not surprising that civil RICO has been used for extortive purposes, giving rise to the very evils it was designed to combat."

In fact, the opponents of RICO reform have, on several occasions, proudly embraced this inequity by arguing that treble damage claims are appropriate because they produce settlements in which the plaintiffs receive the full amount of what they claim was their injury. This result is only fair if one assumes that anyone who is sued in a civil suit should be automatically liable, and thus should pay the full amount demanded as compensation, even if the plaintiff never has to prove his case.

If, however, one accepts what I always believed to be the operating premise of our system of justice -- that a defendant is not liable until he has been shown to have done something wrong and the plaintiff has proved the extent of any loss -- then the threat of treble damages should not so skew

the system that defendants are forced to pay full amount of alleged damages without the plaintiff ever having to prove liability or loss. Yet, that is precisely the manner in which RICO has skewed civil commercial litigation today.

Little has changed in the two years since we were first before this Committee. Despite the assertions by some that the level of misuse of the statute would drop off, it in fact continues. Looking just at cases reported in the last year, the statute is still being invoked in:

-- landlord-tenant disputes, see, e.g., Bros v. Culvers, 650 F. Supp. 874 (D.D.C. Jan. 5, 1987), reported in 2 Civil RICO Report (BNA), January 28, 1987, at 3;

-- child-custody disputes, see, e.g., McMurty v. Brasfield, Civil No. 86-1425-A (E.D. Va. 1987), reported in 2 Civil RICO Report (BNA), March 24, 1987, at 5;

-- sexual harassment cases, see, e.g., Hunt v. Weatherbee, 626 F. Supp. 1097 (D. Mass. 1986), Schulz v. Botica, Civ. No. 86-C-20113 (N.D. Ill. June 25, 1987), reported in 3 Civil RICO Report (BNA), October 13, 1987, at 3;

-- zoning battles between rival developers, see, e.g., HMK Corp. v. Walsey, No. 86-3582 (4th Cir. September 17, 1987), reported in 3 Civil RICO Report (BNA), September 29, 1987, at 4;

-- a chiropractor's attack on a peer review board, Sigmond v. Brown, No. 86-6591 (9th Cir. September 18, 1987), reported in 3 Civil RICO Report (BNA), September 29, 1987, at 6;

-- disputes between employers and employees over discharges, see, e.g., Acampora v. Boise Cascade Corp., 635 F. Supp. 66 (D.N.J. 1986); and even

-- personal injury cases, see, e.g., Wooten v. Loshbough, 649 F. Supp. 531 (N.D. Ind. November 26, 1986), reported in 2 Civil RICO Report (BNA), February 10, 1987, at 3.

And the pace of RICO litigation has not abated. Judges and practitioners report that, if anything, RICO claims are becoming even more frequent and routine in ordinary disputes that would not be viewed as involving "racketeering" in any sensible understanding of that concept.

Since we testified two years ago, the federal courts have repeatedly criticized the overbreadth of civil RICO and the unfair consequences it has for the targets of these suits. See, e.g., Furman v. Cirrito, No. 86-7283 (2d Cir. Sept. 1, 1987), reprinted in 3 Civil RICO Report (BNA), October 13, 1987, at 1 ("The instant case is a paradigmatic example of the unfairness that results when RICO, a statute intended to be an 'assault upon organized crime and its economic roots' is used in an attempt to make a 'federal case' of a simple falling out between partners"); Condict v. Condict, 815 F.2d 579 (10th Cir. March 25, 1987), reprinted in 2 Civil RICO Report (BNA), April 21, 1987 at 2 ("[T]his is but an unsuccessful effort to dress a garden-variety fraud and deceit case in RICO clothing"); Mastercraft Indus., Inc. v. Breining, No. 86 Civ. 6384 (S.D.N.Y. July 28, 1987) ("the facts of this case provide

graphic support for the frequently made assertions by the statute's detractors that the statute is being woefully abused by the civil bar"); HMK Corp. v. Walsey, No. 86-3582 (4th Cir. September 17, 1987), reprinted in 3 Civil RICO Report (BNA) Sept. 29, 1987 at 4 ("Nothing in [plaintiff's] allegations sets this dispute above any other dogfight between developers. The fact that a developer must seek multiple permits and approvals does not bring every such controversy within the ambit of RICO").

While many opponents of RICO reform also assert that these cases, especially the most bizarre distortions of the statute, are dismissed at an early stage, that is simply not true. For instance, even though RICO expressly bars recovery for personal injury damages, by clever pleading the plaintiff in one of the cases mentioned above avoided dismissal of his RICO claim -- for compensation of personal injuries. In others of these cases there were similar results. The fact is that a clever lawyer working with the broad language of this statute can transform many, many types of disputes into RICO actions.

Of greatest concern to the accounting profession is the fact that RICO continues to be used to evade the standards of the securities laws and to raise the stakes in ordinary litigation arising from securities transactions. See, e.g., Youmans v. Simon, 791 F.2d 341 (5th Cir. 1986) (although court dismisses federal securities law claims due to absence of "security," court allows RICO claim to proceed); Ackerman,

Jablonski, Porterfield & De Ture v. Alhadeff (D. Wash. April 16, 1986), reprinted in 2 Civil RICO Report (BNA), July 2, 1986, at 7 (court dismisses § 12(2) claim under Securities Act due to statute of limitations; court allows RICO claim to proceed); Ahern v. Gaussoin, 611 F. Supp. 1465 (D. Ore. 1986) (court grants summary judgment on some issues to some defendants in an 18 page discussion of securities law issues, but permits plaintiffs to use civil RICO claims to bypass the securities law standards); Nunes v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 609 F. Supp. 1055 (D. Md. 1985) (court dismisses certain counts brought under securities laws, but denies motion to dismiss RICO counts).

Plaintiffs have also used RICO to bypass the standards applicable to the antitrust laws, another carefully-crafted federal remedial statute. Wilson v. First Interstate Bank, No. 85-3640 (9th Cir. 1987), reprinted in 2 Civil RICO Report (BNA), May 5, 1987, at 3 (price-fixing claims dismissed but RICO claims allowed to proceed); Genex Corp. v. G.D. Searle & Co., Civ. No. JFM-85-4154 (D. Md. July 17, 1987), reprinted in 3 Civil RICO Report (BNA), August 25, 1987, at 5 (although antitrust claim is dismissed due to lack of anti-competitive effects, RICO claims allowed to proceed).

The Compromise During The 99th Congress

As the Committee is well aware, when we first appeared before this Committee in 1985, we advocated strongly the creation of what has come to be known as a "prior criminal

conviction requirement" for private civil RICO actions. We have always believed, and believe to this day, that that proposal offers the fairest and most efficient solution to the RICO problem, and that it is in harmony with Congress' original intentions when it enacted this law enforcement statute. That proposal had the support of a broad-based coalition of business and labor organizations, and it garnered over 150 co-sponsors in the House of Representatives.

Nevertheless, a powerful if numerically limited faction stood in the path of this proposal, and so the supporters of reform, with AICPA taking the lead, undertook long months of arduous negotiations in an effort to reach a compromise. In the waning days of the last session of Congress, we helped to hammer out a compromise proposal that was hardly ideal, but which for most of the business and labor groups did meet the criterion for support -- it represented an improvement over the current law.

The single most important issue in evaluating any proposal to reform RICO was -- and is -- whether it provides a clear limitation on the types of suits for which the plaintiffs may invoke this special federal anti-racketeering statute to claim treble-damages. Only such a bright-line limitation will allow business people, especially professionals who suffer injury simply from the institution of RICO-type litigation, to seek early dismissal of inappropriate cases. Fiddling with the standards of proof and creating new factual issues that cannot

be resolved short of trial do very little as a practical matter to limit litigation or the assessment of the defendant's risks.

The compromise bill in the last Congress, H.R. 5445, made many concessions to those who wished to preserve a RICO-type federal, multiple damage remedy for "consumers." However, it also recognized the need to create bright-line tests, particularly in those areas, such as securities-related transactions, where the greatest portion of civil RICO claims occurred and where federal law already regulates behavior directly and extensively. Therefore, the compromise proposal allowed RICO plaintiffs in securities-related litigation to continue to seek their actual damages, and even attorney's fees, but simply eliminated their ability to seek a multiple-damage windfall in transactions covered by federal or state securities laws.

This proposal obviously required a substantial concession by the potential defendants in such suits, and clearly it would have preserved many of the problems associated with civil RICO actions. Nevertheless, in the spirit of compromise and in light of our desire to see some legislation pass before the Congress ended, we supported that compromise bill. But, in all honesty, I must tell you that it was a very, very close question for many supporters of RICO reform, and some advocates of reform, in fact, ended up opposing the legislation.

The compromise legislation passed the House of Representatives by a nearly unanimous vote. Since the time left for passage before the Congress adjourned was extremely limited, Senator Metzenbaum offered the identical proposal on the floor of the Senate as an amendment to the continuing resolution, and the current Chairman of this Committee spoke in favor of its adoption. Nonetheless, the proposal failed by a vote of 44 to 47. Thus, RICO reform came within two votes of being enacted by the last Congress.

RICO Reform Today: The Problem With S. 1523

Today, the AICPA remains ready to support the legislation that came so close to passage last year. In fact, the bill pending in the House now, H.R. 2983, which Representative Boucher introduced with the broad bipartisan co-sponsorship of eleven of his colleagues on the House Judiciary Committee, is very similar to last year's bill, and has the support of the AICPA. However, S. 1523, the bill pending before this Committee, differs from last year's legislation and from H.R. 2983 in one respect that is so critical that the AICPA opposes the legislation in this form and urges that it be amended to eliminate this one major defect.

In order to understand the AICPA's position, we believe the Committee must understand the process of extensive negotiations that began at the beginning of this session of Congress and that has led us to this point today.

As I suggested earlier, H.R. 5445 failed to pass the Senate last year in part because of the objections of certain elements of the business community who felt that the compromise did not give them sufficient relief from abusive RICO suits. Therefore, as the current session of Congress began, efforts also began to amend H.R. 5445 to satisfy both the business community and the other interested parties. Changes were indeed made to satisfy some -- although by no means all -- of the concerns of those who had opposed last year's compromise.

However, as those negotiations progressed, it became clear that Senator Metzenbaum believed that the limitation of damages in RICO cases involving securities transactions had to be narrowed. Therefore, with representatives of the AICPA again playing a major role, months of discussions with Senator Metzenbaum and his staff began in an effort to come up with a formulation that would satisfy the Senator's concerns while still giving the principal targets of civil RICO suits some real relief. It was explained to us that the insider trading scandals that have hit Wall Street in the last year had changed the climate and required some response. In response, the AICPA and others seeking reform quickly agreed to an exception to the limitation on damages for insider trading cases. That exception is part of the legislation introduced in the House that has our support.

That compromise apparently was not satisfactory, although it seems to us to address the stated objection, and so

our representatives suggested several different proposals over a period of weeks. Each of those proposals would have also carved out cases of truly "egregious conduct" from the securities exception. In each instance, the proposals were either rejected outright or countered with a proposal that would have so diluted the "securities law exception" as to leave the principal defendants in civil RICO actions faced with virtually the same litigation they face today.

One of those counterproposals is embodied in S. 1523. S. 1523 would permit plaintiffs in civil RICO suits to continue to seek multiple damages even when their claim is based on conduct otherwise covered by the securities laws, if the plaintiffs are "small investors." The term "small investors," however, is defined to include all persons whose household portfolio of securities is valued at less than the median household portfolio in the United States or whose household income is less than the median United States household income.

By definition, the so-called "small investor" exception actually sweeps in more than fifty percent of the over 45 million investors in securities in this country. Because of the limited class of investments to be counted in determining whether a person is a "small investor," S. 1523 would permit multiple damages for the wealthy investor who happens to have most of his holdings at the opportune moment in money market funds rather than in "securities" as defined in the bill. S. 1523 also would sweep in as a "small investor"

the wealthy retiree who may have millions in investments but who is able to show income for a particular year as below the national median, because of losses or carry-forwards or some similar tax advantage.

More fundamentally, however, for the principal targets of civil RICO suits, this "small investor" feature of S. 1523 fails to pass the basic criterion for any legislation designed to reform civil RICO. It does nothing to cut back on the substantive reach of the statute in securities litigation -- the major source of civil RICO litigation. Any case that could be brought under RICO today could be brought if S. 1523 were enacted.

Moreover, the most substantial civil RICO claims arise not just in securities-related litigation, but in class action securities litigation. RICO creates the greatest havoc in those cases, with millions of dollars of damage claims at stake, because it permits the trebling of those claims. While S. 1523 might theoretically reduce the degree of exposure in class action lawsuits, its impact in any particular case would be uncertain and probably would not be ascertainable. As a practical matter, it will be impossible in any particular litigation brought on behalf of "purchasers" or "sellers" of stock to know how many of the "purchasers" or "sellers" also qualify as "small investors." There certainly will be sufficient numbers to allow the litigation to proceed, however, and so the defendant as a practical matter -- the bases upon

which all RICO reform proposals must be judged -- will be in virtually the same position he is in today -- forced to settle for extortionate sums.

Indeed, the net effect of S. 1523 would be much worse than current law for the targets of securities-related litigation, because it effectively would expand, not limit, the substantive impact of the RICO statute in this most important area. Some courts, even after Sedima, have been reluctant to allow claimants to get away with the most transparent distortion of Congress's original intent in enacting RICO -- to provide a remedy for repeated criminality. However, if Congress enacts S. 1523, with its implicit endorsement of civil RICO as a national federal fraud statute and its explicit authority for "small investors" to sue for multiple damages in securities cases, Congress will be signalling the courts that it wants the statute to be used in those cases. Under those circumstances, the courts are likely to entertain RICO claims that today they would view as not covered by the statute. Plaintiffs' lawyers may relish that prospect, but that result would be a long way from providing the reform that Congress has been trying to fashion.

Not only will more cases then survive motions to dismiss, but the federal courts will be clogged with more RICO cases. With the judicial skepticism to RICO overridden by a congressional endorsement of the statute's use in securities cases, with multiple damages available for "small investors,"

and, most importantly, with attorney's fees available in all cases, the statute will provide even greater incentives for attorneys looking to collect a fee to bring cases that never before merited litigation.

Moreover, the experience of our litigators to date has been that some of the most respected and able firms that handle securities litigation for plaintiffs now do not appear to bring RICO claims with regularity. One of the principal reasons for their reluctance to use RICO appears to be their belief that their securities cases might be undermined in the eyes of the court if they append a RICO cause of action. If Congress endorses the use of the statute in securities litigation, however, that reluctance to use the statute would dissipate.

On balance, then, the costs of S. 1523, measured by the expected increase in litigation that plaintiffs would bring and that would survive threshold motions, outweigh the uncertain benefits of limiting, in a very indefinite manner, the class of potential multiple damage plaintiffs. Congressional endorsement of the use of this statute in normal securities disputes -- which would be the effect of passage of S. 1523 -- without any limitation on the substantive reach of the statute, would create significant and substantial new exposure for all potential defendants in the full range of securities litigation -- which includes not only accountants, but lawyers, brokers, underwriters, and issuers -- without providing any real corresponding benefit.

S. 1523 does offer clear, direct, and effective relief from liability for minor segments of RICO defendants -- such as business defendants sued by other businesses. However, for the single largest portion of RICO defendants -- those involved in cases arising from securities transactions -- the legislation promises to make matters worse. Such so-called "RICO reform," which would not provide true, substantial, and effective relief for the principal targets of civil RICO suits -- in fact, would make matters worse -- would be a sham, and the AICPA would continue to oppose any such proposal.

However, one alteration -- the elimination of the so-called "small investor" exception -- would redress the imbalance in the legislation significantly and offer some substantial relief in exchange for some continued exposure. Thus, the AICPA could support it, as it does the legislation pending in the House of Representatives. If this one major alteration in S. 1523 is accomplished (along with a few minor amendments to bring S. 1523 into conformity with the House bill), we believe Congress could swiftly enact true RICO reform with the support of virtually all those who have been involved in this effort since 1985. That type of legislation would offer some real relief to the targets of the statute's present misuse while, for the first time, giving Congressional endorsement to the use of the federal courts by consumers in certain circumstances to seek treble damages for fraudulent misconduct.

That compromise, we believe, is more than fair. We urge the Committee to amend S. 1523 accordingly.

November 1987

RESPONSES OF BERNARD Z. LEE, TESTIFYING ON BEHALF OF
THE AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS,
TO WRITTEN QUESTIONS POSED BY SENATOR STROM THURMOND
RELATING TO PROPOSED CIVIL RICO REFORM LEGISLATION

Question No. 2 (addressed to Mr. Lee)

"Mr. Lee, on page 8 of your written remarks you state: 'Of greatest concern to the accounting profession is the fact that RICO continues to be used to evade the standards of the securities laws and to raise the stakes in ordinary litigation arising from securities transactions.' How does this interfere with the policies behind federal securities laws? Do you believe that the civil RICO remedies of S. 1523 could be used to circumvent the current limitation on recovery allowed by the securities laws?"

Response

For fifty years, Congress has carefully considered the nature and extent of statutory oversight of the securities markets. The Securities and Exchange Commission and other regulatory agencies have implemented the laws Congress passed by applying with equal care their expertise in analyzing when and how to interpret and enforce the laws most effectively, fairly and efficiently. The courts, too, have interpreted the acts of Congress and of the administrative agencies to carry forth the goal of fair and efficient capital markets.

Thus, for instance, in Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 737-49 (1975), the Supreme Court explained in careful detail why the delicate balance of policy considerations underlying the securities laws supported the conclusion that only a person who actually purchased or sold securities could sue under the anti-fraud provisions of the federal securities act.

Congress itself has made adjustments in the statutory system where appropriate, such as the passage of the Insider Trading Sanctions Act of 1984. Today, the Congressional committees with responsibility for overseeing enforcement of the securities laws have a wide variety of proposals under consideration designed to address many issues concerning the trading of securities that have arisen in the last few years. I think all would agree that there are no easy solutions to those issues, but that they must be addressed in a manner that preserves both the integrity and the efficiency of our capital markets, which have long been considered the best in the world.

It is this system, carefully crafted over the last fifty years by all three branches of the federal government, along with the participation of state governments, that civil RICO undermines. Under civil RICO, plaintiffs can bring cases where the securities laws do not envision them, and they can use the threat of treble damages, attorney's fees, and the public opprobrium of being accused of criminal behavior to attack defendants without regard to the balance struck under the securities laws.

This threat inevitably will affect the willingness of individuals and businesses critical to the functioning of the capital markets to participate in the process of raising capital. For instance, public accountants play a critical role, through the auditing of financial statements, in the process by which companies market their securities and thus

raise critical capital. Civil RICO threatens to limit the willingness of accountants to participate in that process. I have been involved with public accounting for several decades, and have occasion to speak regularly with many members of my profession throughout the nation. I believe that, if civil RICO remains unaltered, and juries begin to return multi-million dollar judgments, those now in public accounting will be less willing to perform the attesting function and, when they do participate, will do so only under more constraining conditions.

Others would react similarly, and the impact on the capital markets cannot easily be predicted. That is why we must not allow this statute to continue to undermine the established system of regulation and to be used to bypass the statutes and regulations that have evolved throughout the decades with the needs of the investing public and the economy directly in mind.

S. 1523, in its current form, would make matters worse in securities-related civil RICO litigation. As I explained in my testimony, the legislation would do nothing to limit the substantive reach of the civil RICO claims raised in securities cases, and it would do practically nothing to limit the incentives to use the RICO statute in those cases. To the contrary, because Congress effectively would be endorsing the use of civil RICO to seek multiple damages in securities cases if it passed S. 1523, the net result would be to increase the

number of securities-related civil RICO cases filed and the number that would survive early dispositive motions.

If the Committee removed the so-called "small investor" language from the bill, the AICPA believes that the legislation would provide substantial reform and should be enacted. We do not pretend that it would be a perfect solution, or that it would remedy all the problems civil RICO creates. However, the bill at least then would create a clear cut test that would limit significantly both the incentives to misuse civil RICO to undermine the securities laws and the rewards for doing so.

Our criterion for evaluating proposals to reform civil RICO has always been whether a reform proposal would be better than current law. S. 1523 with the "small investor" language fails that test. Without it, it would pass.

Question No. 3 (addressed to any panel member)

"A tort victim must have an appropriate legal remedy. However, there has been no evidence brought forward that State courts have failed to provide such a remedy: By permitting lawsuits for recovery of punitive damages, doesn't this bill unnecessarily federalize broad areas of State common law and State statutory causes of action?"

Response

As the Senator is well aware, the AICPA originally supported a proposal to create a "prior criminal conviction" requirement for all private civil RICO actions. As I stated in my testimony, we continue to believe that that proposal

represents the fairest and most effective method for refocusing civil RICO on its intended purposes. However, as with most legislative efforts, we have recognized that compromise is necessary in order to get some relief for the victims of civil RICO litigation. Thus, the AICPA is willing to evaluate any proposal to reform civil RICO by its one criterion: would it improve current law.

The provision to which Senator Thurmond refers is one such compromise. Virtually all of the premises that underlie his question are correct. However, the fact is that civil RICO already federalizes broad areas of state common law and state statutory causes of action, and also creates tremendous incentives to use RICO instead of state remedies, because it offers to the plaintiff automatic treble damages, attorney's fees, broad discovery, and the ability to smear the defendant with the label "racketeer."

S. 1523 must be evaluated in that context. It would cut back in several ways on the incentives to use RICO to federalize state causes of action. First, it would eliminate the windfall of automatic treble damages in all private suits, except where there has been a prior criminal conviction. Second, it eliminates multiple damages from all suits brought by businesses and organizations. Third, it would permit "consumers" to continue to seek treble damages, but they at least would not be awarded automatically and would require, at least in theory, proof of particularly egregious behavior

beyond what is necessary to prove RICO liability alone. Fourth, the bill would provide a few additional protections, such as the elimination of the "racketeering" label, which would help to limit to some degree the extortive value of a RICO claim.

As we have stated repeatedly, because securities-related RICO claims represent the single largest portion of civil RICO claims, and securities transactions are directly and carefully regulated under federal law, we do not believe that this package of amendments alone provides sufficient real relief for the targets of civil RICO suits to justify accepting, among other defects in the civil RICO statute, continued federalization of claims traditionally litigated under state law in state courts. In order to justify that federalization and the other elements of civil RICO liability, the principal targets of civil RICO lawsuits -- the defendants in securities-related litigation -- must be provided the type of clear relief which we advocate.

Unfortunately, civil RICO already has "unnecessarily federalize[d] broad areas of State common law and State statutory causes of action." That is why the Judicial Conference of the United States twice this year called upon Congress to "narrow significantly" the civil RICO cause of action. Thus, the issue becomes whether Congress can enact legislation that will provide some substantial relief that would justify accepting some continued exposure. The AICPA

does not believe S. 1523 in its present form is a substantial improvement over current law. We do believe that, if the Committee eliminated the "small investor" provision, it would deserve the support of those who wish to see Congress provide at least some real relief for the targets of civil RICO litigation.

Question No. 4 (addressed to any panel member)

"Earlier legislation proposed that one way to eliminate RICO abuse was to require that one of the predicate acts be an offense other than mail or wire fraud. What is your view of this alternative?"

Response

That earlier proposal was commendable in its recognition that one of the principal sources of the misuse of civil RICO is the breadth of the mail and wire fraud "predicate acts." Unfortunately, we believe that, if the legislation addressed only those two predicate acts, clever plaintiffs' attorneys would find other ways to plead civil RICO claims in ordinary litigation. For instance, they still would be able to use the broadly worded predicate act of "fraud in the sale of securities" to evade the substantive and remedial provisions of the securities laws, and similarly use 18 U.S.C. § 2314, which reaches the interstate transportation of funds obtained allegedly through fraud. Since it is impossible to predict the context in which civil RICO claims might arise in the future, and nor is it possible to know what other predicate acts Congress may wish to add to RICO in the future, limiting the

focus on two predicate acts may well prove inadequate, both for the present and for the future.

If the Committee wished to take the approach to civil RICO reform that the earlier proposal offered, the Committee should seek to avoid simply creating new pleading hurdles that clever attorneys will be able to jump successfully. One way to do that would be to limit the private civil RICO remedy to cases in which the plaintiff can plead the violent predicate acts traditionally associated with true organized criminal activity and are contained in 18 U.S.C. § 1961(1)(A).^{*/} Even that approach would leave loopholes to be exploited -- *i.e.*, plaintiffs have pleaded successfully "extortion" in some cases that appear on their face to involve ordinary commercial disputes, *see, e.g., Battlefield Builders, Inc. v. Swango*, 743 F.2d 1060 (4th Cir. 1984). This proposal, however, would eliminate most potential misuse of the civil RICO action while still leaving it available for private plaintiffs injured by organized criminal activity as that phrase is commonly understood.

^{*/} 18 U.S.C. § 1961(1)(A) includes "any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, dealing in obscene matter, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year."

Senator METZENBAUM. Let me just ask you one question, Mr. Lee. If you can get this bill or no bill, is it my understanding that you would rather have no bill?

Mr. LEE. Yes, sir. We do believe that no bill would be better than one that contains the so-called "small investor" language currently in S. 1523. If that language were removed we would then be prepared to support S. 1523.

Senator METZENBAUM. And, Mr. di Buono, you are for this bill, so I do not have to ask you that question.

Mr. DI BUONO. Yes, sir.

Senator METZENBAUM. Mr. Lacovara, you are here with Mr. Hyman—I mean with Mr. Lee.

Mr. LACOVARA. With Mr. Lee, sir.

Senator METZENBAUM. Pardon?

Mr. LACOVARA. With Mr. Lee.

Senator METZENBAUM. Yes.

Mr. David Hyman, General Counsel of Bear, Stearns.

Mr. HYMAN. Yes, sir. SIA has not taken a position, is neutral, on whether if the bill had to contain the small investor provision, the SIA would be in favor of it. Bear, Stearns as a firm would feel if the bill had to contain that that we would rather see the legislation passed than not at all.

Senator METZENBAUM. You would rather have it with the exemption if that is the price of getting the bill?

Mr. HYMAN. That is the position of Bear, Stearns.

Senator METZENBAUM. But that is Bear, Stearns; you are not speaking for the securities industry?

Mr. HYMAN. I know a number of firms feel that they could not live with this, while some feel that they could, depending on their type of business.

Senator METZENBAUM. Please proceed.

Mr. HYMAN. Mr. Chairman, my name is David Hyman. I am a managing director of Bear, Stearns & Co., and chairman of the RICO Committee of the SIA. Today, I am appearing on behalf of SIA to discuss S. 1523.

The Department of Justice has successfully used RICO through the years in criminal prosecutions, particularly against organized crime. This legislation has proven to be an extremely valuable tool in the war on crime. Anything that Congress can do to strengthen the government's ability either to prosecute criminally or to use civil remedies through the use of RICO should be considered.

Only a small portion of the act has proven to be troublesome, and that is the private cause of action. There is a common consensus among reasonable people that this section of RICO has been perverted to attack the very people who are supposed to be protected by RICO.

Several writers have criticized RICO by pointing to some of the obviously frivolous suits that have been brought, but that does not point up the real vice of RICO. A case containing the most serious allegations of fraud may be a misuse of RICO because the claims may be unfounded.

The major fault of civil RICO lies in the fact that it tilts the scales of justice in favor of the plaintiff. It is the recognition of this fact that plaintiffs are placed in the position of being able to extort

unreasonable settlements from defendants that prompted four of the nine Justices of the Supreme Court in the *Sedima* case to vote in favor of interpreting civil RICO to require a prior criminal conviction as a predicate for the bringing of a claim.

All the Justices in the *Sedima* case called upon Congress to reform civil RICO. It should be pointed out that no one is asking for criminal immunity under the RICO Act, nor is SIA asking for any type of immunity for so-called white-collar crime.

What SIA is asking is that Congress not disturb the body of statutes, decisions, and SEC regulations which comprise the securities law in the United States. This large body of law has evolved over 50 years in a careful manner so as to encourage capital formation, while providing clear, effective remedies.

SIA endorses all of the provisions of the amendment to the private cause of action, with reservations as to the small investor provision carve-out from the exemption from punitive damages.

The number of people qualifying for this carve-out will be quite extensive and will only moderately diminish the number of potential plaintiffs. It must be realized that the criteria used to define small investor can easily include investments which would qualify a person who has substantial worth.

The elimination of the small investor carve-out will in no way create any undue hardship on the public, since there are available any number of remedies to redress wrongs occasioned by securities fraud, including the whole remedy of federal securities acts, the State securities acts and, in particular, common law fraud under which punitive damages can be awarded.

Punitive damages in securities cases have been reported on numerous occasions and, under RICO, it would be possible for a plaintiff to recover both common law punitive damages and RICO punitive damages.

The creation of the small investor carve-out suggests that small investors are somehow at a disadvantage in bringing suits against brokers and others from whom they may have purchased securities, and that the threat of treble damages is needed somehow to balance the scales. This is not the case. While it may not be economical to bring suits in some small cases, arbitration offers a quick, efficient and fair means for investors to resolve disputes that they may have.

Thank you, sir.

Senator METZENBAUM. Thank you very much, Mr. Hyman.
[Statement follows:]

TESTIMONY OF
M. DAVID HYMAN
ON BEHALF OF THE
SECURITIES INDUSTRY ASSOCIATION
BEFORE THE
SENATE COMMITTEE ON THE JUDICIARY
OCTOBER 29, 1987

Good afternoon. My name is David Hyman, Managing Director of Bear, Stearns & Co. and Chairman of the RICO Committee of the Securities Industry Association ("SIA"). ^{1/} Today I am appearing on behalf of the SIA to discuss S.1523, a bill to amend the Racketeer Influenced and Corrupt Organizations Act ("RICO").

Mr. Chairman, you should understand that SIA has been working for more than three years with other business and labor groups, and with both the House and Senate Judiciary Committees, to obtain relief from the onerous civil litigation provisions of the statute. The case for reforming the statute has been made forcefully at previous hearings. The Supreme Court clearly recognized that the civil provisions of the statutes have been used for purposes not contemplated by Congress. The Supreme Court recognized these deficiencies and left their correction to Congress.

Concern about the enormous number of RICO claims in securities litigation prompted legislative action in the 99th Congress. The American Institute of Certified Public Accountants galvanized the Washington community into action and

^{1/} The Securities Industry Association is the trade association representing over 500 securities firms headquartered throughout the United States and Canada. Its members include securities organizations of virtually all types--investment banks, brokers, dealers and mutual fund companies, as well as other firms functioning on the floors of the exchanges. SIA members are active in all exchange markets, in the over-the-counter market and in all phases of corporate and public finance. Collectively, they provide investors with a full spectrum of securities and investment services and account for approximately 90% of the securities business being done in North America.

the legislation produced by that effort fell short of becoming law by only two votes in the Senate.

Since that time, little has changed. RICO litigation continues to expand in all areas of the law, including securities litigation. It continues to be used in a manner that disrupts the orderly adjudication of securities claims, and sometimes turns any notion of justice on its head. Complaints alleging fraud, either in the sale of securities or the underwriting of securities, routinely contain RICO claims. In some cases, Courts have dismissed a cause of action relating to securities underwriting, while allowing a RICO claim to go forward. This demonstrates the absurd tilting of the scales of justice to favor plaintiffs. In our industry, an unblemished reputation for integrity and honesty is essential. Even a baseless charge of racketeering places undue pressure on the settlement process. A defendant will settle an unmerited claim rather than risk his reputation and livelihood through protracted litigation. Once again we must remember that but for two votes, Congress would have solved the problems described above by eliminating the possibility of treble damage recovery in all claims arising out of federal and state securities law.

The mere allegation of securities fraud does not and should not entitle plaintiffs to extort unreasonable settlements from defendants. This consideration prompted four of the nine Justices of the Supreme Court in the Sedima case to favor interpreting civil RICO as requiring a prior criminal conviction of the defendant before a RICO claim can be brought. Justice Marshall put it well when he wrote, "many a prudent defendant facing ruinous exposure will decide to settle even a case with no merit." Since the enactment of RICO in 1970, the Department of Justice has successfully used RICO in criminal prosecutions. This legislation is an extremely valuable tool to combat organized crime. Congressional efforts to strengthen criminal prosecutions, or the civil remedies available through RICO, should be considered and acted upon favorably.

Attached to this testimony is a series of editorials from The Washington Post, The Wall Street Journal, The Christian Science Monitor and others, all calling for a reform of this section. As the Washington Post points out, the private right of action provided by RICO was used by a citizen annoyed by the way Democratic Party funds were distributed. He sued Walter Mondale and the Democratic National Committee as racketeers. The FBI has been sued in the same fashion. The American Broadcasting Company as well as religious congregations and utility companies, just to name a few, have all been sued as racketeers. The Supreme Court in Sedima called on Congress to reform the private right of action in the RICO Act. That right is obviously being used for purposes which are inconsistent with the original intent of the law.

S. 1523 contains a number of provisions that reform the civil liability provisions of RICO to restore the original

congressional intent while curbing abuses that have crept into civil RICO litigation. These provisions were the result of negotiations among the various interest groups, the Congress, and representatives of consumer groups. These provisions address and correct specific problems uncovered during hearings and discussions that led up to the amended version of H.R. 5445.

The securities industry's particular problems arise from the punitive damage provisions for natural persons in "consumer" transactions. In general, securities fraud is exempt from the punitive damages provision because of the highly developed statutory scheme of liability found in the Securities Act of 1933 and the Exchange Act of 1934. Two exceptions to the general exemption are provided. The first is for conduct that violates the Insider Trading Sanctions Act, and the second is for small investors. As early as 1983, SIA endorsed the concept of treble damages for insider trading violations and worked for the passage of the Insider Trading Sanctions Act which embodied that concept. SIA established a special committee to examine trading practices in January of this year and its report once again condemned insider trading, and called for the Congress to define and punish insider trading violations. The industry can endorse treble or sextuple damages for anyone found guilty of trading on inside information.

SIA cannot endorse the second exception for "small investors". This exception takes an otherwise well-crafted exemption and reopens the industry to potential RICO litigation involving 50 to 60 percent of all investors.

The "small investor" feature of S. 1523 is troubling in a number of respects. Securities-related RICO actions constitute the single largest portion of RICO cases. For the proposed reforms to be truly meaningful, significant reductions in the number of RICO cases brought in conjunction with securities fraud claims must be achieved. By definition, the "small investor" exception includes upwards of fifty percent of the over 45 million securities investors in this country; as well as those whose income for a given year falls below the median, whether because of current or carry-forward losses, or other tax-related strategies. Then too, the most burdensome civil RICO claims often arise in class action securities litigation. RICO presents the greatest threats in such cases because of the potential trebling of claims which may initially be measured in millions of dollars. While S. 1523 offers some relief from such cases, it seems clear that these cases will continue to be brought and allowed to proceed. Thus, defendants will still be subject to extortionate threats of treble damages, which force settlements when claims are weak or even baseless.

Perhaps the most pernicious aspect of the small investor carveout is its potential effect on the willingness of courts to throw out RICO counts on a variety of grounds, and the consequent willingness of plaintiff's bar to include RICO counts in every securities fraud claim. Both before and after

Sedima, some courts have been unwilling to permit plaintiffs to use RICO except as a remedy for habitual criminality, which was, after all, Congress' original intent. However, enactment of S. 1523 with the small investor provision intact, would signal Congress' acceptance of RICO as a national federal fraud statute. This in combination with its explicit support for "small investor" treble damage actions, will persuade courts to accept RICO claims where they might be ill-received currently. Not only will these cases survive motions to dismiss, but the eagerness of the plaintiffs' bar to file actions may rise exponentially with the availability of attorney's fees in all cases, and multiple damages availability for "small investors".

The elimination of the "small investor" carveout will not create any undue hardship on the public since there already are many remedies available to redress wrongs occasioned by securities fraud: federal securities acts, state securities acts, and common law. Multiple damages beyond treble damages are already available under state and common law. It is the availability of this multitude of remedies which makes the private right of action in RICO not only unnecessary but extremely mischievous. Congress has long protected the investing public from securities fraud and the courts have carefully articulated the definitions of that fraud and the limits to which it can be applied. The problem with civil RICO is the unintended "loose cannon" it has turned against the carefully woven fabric of federal securities laws, and the age-old interpretation of state common law.

At the time of the passage of RICO, several members of the Congress objected to the possible abuse of the RICO statute by arguing that it could be used "to harass innocent businessmen."^{2/} Nothing could have been more prophetic. Today the private right of action in RICO is not used against criminals or organized crime but rather against the very businesses which RICO was intended to protect. Justice Marshall, in his dissent in the Sedima case, pointed out that only nine percent of all Civil RICO cases have involved criminal activity associated with professional criminals.

I applaud the Committee's efforts to reform civil RICO. SIA wholeheartedly endorses all the proposed amendments to the private right of action section, save one - the exception created for the "small investor". I thank you for this opportunity to testify and I will be most happy to answer any questions.

2/ H.R. Rept. No. 91-1549 at 187 (1970), (Dissenting views of Reps. Conyers, Mikva, and Ryan).

The Washington Post

FRIDAY, DECEMBER 6, 1985

Who's a Racketeer?

MEMBERS of Congregation Beth Yetzchok in New York had a dispute over succession to the leadership of their Hasidic congregation, and one faction sued the other in federal court. In another case a citizen, annoyed about the way Democratic Party funds were distributed in the last election, sued Walter Mondale and the Democratic National Committee using the same federal statute. A woman displeased by her divorce settlement, a writer with a gripe against the American Broadcasting Company and a group of tenants protesting their landlord's utility charges all used the same law to bring a civil suit. What's the common thread? It is, believe it or not, racketeering.

Fifteen years ago, Congress passed the Racketeering Influenced and Corrupt Organizations Act, known as RICO. It was essentially a criminal statute aimed at mobsters, but in the House a provision was added allowing persons hurt by organized crime to bring civil suit against the wrongdoers. Plaintiffs could simply allege that they had been harmed by the kind of activity usually associated with organized crime—murder, arson, kidnapping, extortion and various kinds of fraud—and bring their complaints in federal court, instead of overcrowded state courts. In addition, they could win triple damages if their suits were successful.

For about 10 years there was little civil RICO litigation, but since 1981 the number of cases has skyrocketed as all sorts of people began to realize

the potential of the statute. The Justice Department estimates that now only about 7 percent of RICO civil suits involve racketeers of any kind. Most defendants are businesses, brokerage houses, bankers, unions and occasional unlikely parties such as those described above. In most cases the "racketeering" alleged is mail fraud ("he sent the contract through the mail"), wire fraud ("she promised me on the phone") or securities fraud ("they sold me an interest in a business deal that didn't work out").

The Supreme Court has ruled that the RICO statute does in fact authorize all these suits, but even the justices expressed skepticism that Congress intended this result. Dozens of organizations as diverse as the American Bar Association and the United Auto Workers have called for amending legislation and the House subcommittee on criminal justice is now considering a bill introduced by Rep. Frederick Boucher (D-Va.). It would allow civil RICO suits only against persons who already have a criminal conviction for a racketeering offense.

The current law crowds federal courts with run-of-the-mill commercial disputes and allows citizens such as the Brooklyn rabbi and the Democratic nominee—not to mention countless honest businesses—to be smeared with the label "racketeer." Congress should end these abuses and clarify its original intention by passing Mr. Boucher's bill.

REVIEW & OUTLOOK

The RICO Racket

Congress passed the Racketeer Influenced and Corrupt Organizations Act in 1970 to put the mob behind bars. Instead, lawyers are using the bill to extract out-of-court settlements from investment bankers and accountants by calling them "racketeers."

RICO was supposed to bust large, well-organized crime outfits by making convictions easier. The law says that anyone involved in a "racketeering enterprise" that commits any two of several "predicate acts" associated with mobsters—murder and arson, for example—within 10 years can be held liable even if the usual criminal requirements of individual intent to commit a crime aren't met. The idea was to get the top honchos if their underlings were caught.

So far, so good. But the civil side of the law is having serious unintended consequences. Any plaintiff can sue for damages if he was injured by the defendant's "pattern of racketeering activity." But the predicate acts defined in the bill include not only Mafia crimes like murder, arson and extortion, but also mail fraud, wire fraud and "fraud in the sale of securities." The legislative history shows that Congress wanted some way to reimburse people ripped off by the mob stealing or counterfeiting securities. But the way the law was written, any *claim of fraud* can make a RICO case, even if the dispute is a divorce, a sale of land or, as in one case, who should be the next rabbi of a Hasidic sect. Prospectuses with alleged misrepresentations, for example, are turned into racketeering cases if there are two phone calls to take orders to buy the security.

RICO began to be used for run-of-the-mill cases of misrepresentation and other alleged frauds committed by otherwise legitimate businesses a few years ago when lawyers discovered the broad wording of the statute and its lure of treble damages, lawyers' fees and court costs. It's estimated that one-tenth of all cases brought in federal court this year will be civil RICO cases. Lawyers can pursue either the Racketeer Litigation Reporter or the RICO Law Reporter for new ways to sue businessmen whose only contact with a racket may be the occasional tennis match.

The Supreme Court ruled in July in the *Sedima vs. Imrex* case that Congress had obviously made a hash of things. Justice Marshall picked up on the irony of extortion via RICO litigation.

"The defendant, facing a tremendous financial exposure in addition to the threat of being labelled a 'racketeer,' will have a strong interest in settling the dispute," he wrote. There is also the not-so-minor point that attorneys for private parties are in effect indicting people for crimes—a power usually reserved for state or federal prosecutors entrusted with the discretion to use the power of criminal accusation.

The justices noted that three-quarters of the cases brought under RICO were for securities fraud or common-law fraud in a business setting. The American Bar Association reports that only 9% of RICO cases involve offenses associated with professional-criminal activity. If there is any doubt that RICO needs reform, consider the case of *Lightner vs. Tremont Auto Auction*: The supposed "racketeers" were FBI agents who had orchestrated an allegedly faulty sting operation. In accepting the case, a federal court in Illinois ruled the sting was a possible offense under the broad wording of RICO. So the FBI itself was hauled into court under an anti-racketeering law.

RICO is also turning federalism on its head. Fraud has always been a matter of state common law. Under RICO, with its treble damages and lawyers' fees, there is an irresistible urge to go to federal courts. A fraud claim should not become a federal case just because a phone call was made or a letter sent between states. If Congress had really intended to write a federal code to replace state common law, you can be sure it wouldn't have taken the lawyers more than a decade to notice.

The Supreme Court said the bill has bizarre results, but that Congress—not the courts—should fix it. If Congress can spare time from micromanaging the budget this term to undo the damage it created, it can choose from several bills that would ensure RICO would apply only to organized crime. One reform would be to require that a defendant actually be convicted of a crime like murder or blackmail before being sued civilly for one of the fraud counts.

RICO is another embarrassment for Congress and another new game for lawyers. We're all for bills that make it easier to lock up the mob. But the "racketeers" now caught by RICO sometimes are the legitimate businessmen the law was supposed to protect.

February 12, 1986

Time to reform RICO

THE civil provisions of RICO, the Racketeer Influenced and Corrupt Organizations Act, need reform. Intended to help the Justice Department in its campaign against organized crime, RICO has become a growth industry for the nation's lawyers.

What we could call a "classic" civil RICO case might go like this: A beverage distributor is infiltrated by a crime syndicate, whose goons go about making it clear to local retailers that if they don't buy their beverages from this particular distributor, they will find the air let out of their tires, or worse. The authorities catch up with the mobsters, who are then tried, convicted, and imprisoned for extortion.

Meanwhile, an honest distributor has seen his business fall apart because he declines to use the same sales techniques as his mob-infiltrated competitor. Unlike the retailers, he has not suffered directly from extortion. But RICO's civil provisions would allow him to sue the mobsters in federal court, for treble damages plus legal fees, on grounds that his business had suffered as a result of "a pattern of racketeering activity" by the infiltrated distributorship.

This is the theory. To file a civil RICO suit, a plaintiff must allege a "pattern of racketeering activity" in any of several criminal offenses, including extortion, arson, and murder — as well as mail fraud, wire fraud, and fraud in the sale of securities.

It is the fraud provisions that have opened RICO wide as a barn door. The statutes governing fraud, an offense where states generally claim jurisdiction, are written very broadly. District attorneys do not have unlimited resources, and so they use discretion to determine who actually gets prosecuted.

But would-be civil RICO plaintiffs have no such inhibitions. Note that they need only *allege* the criminal offenses to have grounds for their civil suits. Note, too, that mail fraud, wire fraud (i.e., over the telephone), and fraud in the sale of se-

curities can be construed to cover just about any misrepresentation in the business world, even one of no interest to the district attorney. In other words, RICO provisions aimed at organized crime are now being used in lawsuits that do not necessarily involve organized crime.

The list of stock brokerages sued under RICO reads like a Who's Who on Wall Street. RICO has been even more dangerous for smaller firms whose good name in their community is their stock in trade.

RICO is out of control not only because it is so easy to claim grounds for a suit, but because the appeal of treble damages plus legal fees has proved irresistible for plaintiffs and their lawyers.

Moreover, federal courts have a certain cachet which state courts lack, and the last straw is that the name of the act has pushed many defendants to settle rather than fight such suits for fear of being publicly labeled "racketeers."

None of this should blind us to the fact that "legitimate businesses" sometimes commit fraud and other white-collar crimes. In such instances RICO's civil remedies could be as helpful as they are to the honest beverage distributor cited above.

One interesting proposal for reform is to disallow RICO suits unless the defendant has actually been convicted of one of the offenses that can trigger a RICO suit — what the lawyers call "predicate offenses." This would mean that aggrieved parties would still have redress against criminal fraud, but it would eliminate the problem of plaintiff-as-do-it-yourself-district-attorney.

The Supreme Court has upheld civil RICO suits against "legitimate business," saying that if Congress had intended to limit RICO to usual mob activities — extortion, arson, murder — it should have said so.

The courts should not have to write laws because Congress can't be bothered to write them properly. Congress needs to take another look at RICO.

BEAR STEARNS

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November 25, 1987

Honorable Howard M. Metzenbaum
United States Senator
United States Senate
Committee on the Judiciary
Washington, DC 20510-6275

Re: Civil RICO Reform Legislation

Dear Senator Metzenbaum:

I am responding to the two questions proposed by Senator Strom Thurmond.

3. We do not believe S1523 will unnecessarily federalize broad areas of State common law and State statutory causes of action. In our opinion, perhaps half of all lawsuits, that are commenced with a civil RICO treble damage claim, relate to securities litigation. These suits are almost invariably brought in Federal Court and contain as a first cause of action, a claim under the Federal securities law, a second claim under State statutory law (Blue Sky law), a third claim which is usually a State common law fraud claim including a demand for punitive damages, and a fourth claim for treble damages under RICO. Under the proposed amendment, a great many of the suits that are currently being brought would be eliminated. Unless there was a prior criminal conviction for a racketeering offense, all business to business suits would be eliminated as well as all claims that did not involve the purchase of a product or service. While it is true that the "small investor" carve-out will permit securities claims to be brought with a treble damage RICO claim, a substantial number of such claims may be heard in Arbitration rather than in the Federal Courts. On the whole, we believe that the adoption of S1523 will result in a substantial decrease in the number of Federal Court complaints containing civil RICO claims.

4. One proposal to eliminate RICO abuse was to require that one of the predicate acts be an offense other than mail or wire fraud. The Securities Industry Association would support such a proposal if it stated that one of the predicate acts had

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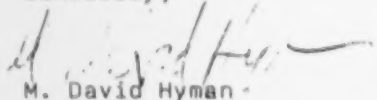
Honorable Howard M. Metzenbaum
 United States Senator
 November 25, 1987
 Page Two

to be an offense other than securities fraud or mail or wire fraud. A more direct way to be sure that the focus is on racketeering would be to require that one of the predicate acts be one of the crimes listed in 18 U.S.C. § 1961(1)(A) which are "any act or threat involving murder, kidnapping, gambling, arson, robbery, bribery, extortion, dealing in obscene matter, or dealing in narcotic or other dangerous drugs, which is chargeable under State law and punishable by imprisonment for more than one year." Clearly, this would eliminate the vast majority of commercial suits presently being brought under RICO. Generally speaking, proof of these additional offenses will require witnesses or objective evidence besides the testimony of the plaintiff. One of the difficulties with the present statute is that fraud can be alleged and supported solely by the testimony of the plaintiff. A plaintiff who takes the stand and relates a conversation with the defendant allegedly making misrepresentations of material fact on two separate occasions may make out a prima facie case under civil RICO. For this reason, the Supreme Court, in the Sedima case, indicated that civil RICO could be used to extort unjustified settlements.

Both S1523 and the proposal to require a violent crime as one of the predicate acts would significantly reduce the abusive use of civil RICO. Which proposal has a better chance of passing the House and Senate is a question on which we defer to the judgement of the members of the Committee.

Thank you for affording SIA the opportunity to testify on this Bill and to respond to your questions.

Sincerely,



M. David Hyman
 Chairman
 SIA Ad Hoc Committee
 To Reform Civil Rico

MDH/eg

60208/20,21

Senator METZENBAUM. I want to thank the entire panel. We appreciate your being with us. We will take your statements and put them in the record and we will proceed on that basis.

The Chair will announce there will be a five-minute recess at this point.

[Recess.]

Senator METZENBAUM. We have six more witnesses and the Chair makes no bones about it that I just do not feel very well, and we could schedule some of you later or Eddie Correia, staff counsel, is prepared to hear your testimony at this point. I think that might be a preferable procedure, but if you feel that that is unfair, then we will schedule for some day next week. But as long as you are here, it seems to me that might be a better way to go.

Four of the people are from Washington, Ernie Dubester, Antonio Califa, Robert Chiesa, Joan Claybrook, Michael Goldsmith, and Lewis Engman—let us see; Michael Goldsmith is from Utah.

Mr. CHIESA. Senator, I am from Manchester, New Hampshire, not Washington, DC.

Senator METZENBAUM. You are absolutely right. It says that exactly right here, Mr. Chiesa.

Mr. CHIESA. Thank you.

Senator METZENBAUM. And would you be perfectly willing to deliver your testimony, which all of us will look at in the record, for the American Bar to Mr. Correia?

Mr. CHIESA. I would be happy to.

Senator METZENBAUM. Thank you very much. I am going to excuse myself. I do want to say this: We have one witness here. Lewis Engman, are you here?

Mr. ENGMAN. Right here. I have the same problem you do, Mr. Chairman.

Senator METZENBAUM. All right. What is your pleasure, Mr. Engman?

Mr. ENGMAN. I would be happy to come back, whatever suits the others.

Senator METZENBAUM. All right. Maybe you should come back at a later point. We will try to work out something. I do not see how you can be sick. You used to represent the American Pharmaceutical Manufacturers, did you not? [Laughter.]

Am I wrong?

Mr. ENGMAN. You are right.

Senator METZENBAUM. All right. Please excuse me. Eddie, will you take over? Thank you.

Mr. CORREIA. Could we hear first from Mr. Dubester?

STATEMENT OF A PANEL CONSISTING OF ERNEST DUBESTER, LEGISLATIVE REPRESENTATIVE, AFL-CIO, WASHINGTON, DC, ACCOMPANIED BY MARY GILSON, COUNSEL; ANTONIO J. CALIFA, LEGISLATIVE COUNSEL, AMERICAN CIVIL LIBERTIES UNION, WASHINGTON, DC; AND ROBERT L. CHIESA, CHAIRMAN, SPECIAL RICO COORDINATING COMMITTEE, AMERICAN BAR ASSOCIATION, MANCHESTER, NH

Mr. DUBESTER. Thank you. Accompanying me this afternoon is Mary Gilson from the law firm of Bredoff and Kaiser in Washington, DC.

I appreciate this opportunity to present the views of the AFL-CIO in support of S. 1523. We believe that the legislation would accomplish one critical step toward curbing the current abuses of the private civil RICO action; namely, the narrowing of the class of private civil RICO actions in which treble damages may be recovered by a plaintiff.

For that reason, while we have maintained that other reforms of the private civil RICO action are also needed, we do urge this committee to give favorable consideration to S. 1523.

I had wanted to, at the outset, commend Senator Metzenbaum for the approach taken particularly in section 2 of the bill, which we think is a proper approach in addressing the unique problems posed by private civil RICO actions, as distinct from criminal prosecutions under RICO, and also from civil RICO actions advanced by governmental authorities.

As you are aware, Congress drafted RICO's substantive provisions broadly so that law enforcement authorities would have the means through the criminal laws to reach organized crime and its assets, and Congress was confident and hopeful that government prosecutors would use their discretion to bring cases against real organized crime.

Of course, this safeguard against abuse—namely, the responsible use of prosecutorial discretion—is not available in the context of private civil litigation, and however one views the wisdom of placing such broad power in the hands of governmental authorities, experience has shown that placing the same power in the hands of private parties whose primary objective is often to further their own interest, not an interest in coherent and effective law enforcement, will produce results that are both destructive to innocent parties and contrary to the goals that RICO was intended to accomplish.

Now, the AFL-CIO has had what is perhaps a unique opportunity to observe how the private civil RICO action actually works. Unions affiliated with the AFL-CIO have been both plaintiffs and defendants in such suits, which are now arising in conventional labor disputes, and that experience to date shows the following:

Private civil RICO actions rarely, if ever, are brought to attack the core conduct that concerned Congress in enacting RICO. As you know, Congress' motivating objective was to end the infiltration of legitimate institutions by organized crime, and the AFL-CIO strongly supports that objective.

But few, if any, private civil RICO actions even purport to address such infiltration. Rather, the typical private civil RICO action

is between parties to ordinary commercial disputes and conventional labor disputes in which the parties have no relation whatsoever to organized crime.

As Justice Marshall expressed in his dissent in the Supreme Court's *Sedima* case, only nine percent of all civil RICO cases even involve allegations of criminal activity normally associated with professional criminals. So the central purpose that Congress sought to promote through civil RICO is now a mere footnote.

As you are also well aware, there is agreement among the courts, again including the Supreme Court, that in its private civil version the statute is being used in many ways unintended by Congress and the courts have been calling upon Congress to reform the statute to bring it in line with its intended purpose.

Today, the private civil RICO action offers a party a broad-ranging, open-ended means of attack, carrying drastic monetary and other remedies as a substitute for the more carefully limited State and Federal causes of action specifically addressed to the kinds of misconduct that such disputes sometimes engender.

In this fashion, not only are the original objectives of the RICO statute undermined, but private civil RICO suits can also be used to undermine the careful judgments which Congress has brought to bear in enacting many federal labor statutes, as well as other areas of federal law.

This increasing use of civil RICO actions to evade the legal standards and regulatory systems of labor statutes is quite disturbing. Equally disturbing is our experience, which is shared by many others, which demonstrates that because of the tremendous risks civil RICO poses to defendants, many will settle rather than contest the suits.

Again, as Justice Marshall wrote in his dissent in *Sedima*, "It is thus not surprising that civil RICO has been used for extortive purposes, giving rise to the very evils that it was designed to combat."

Even where private civil RICO action does not result in a quick settlement, the consequences are likely to be undesirable for all involved. Litigants on both sides become trapped in an unmanageable morass of complicated factual and legal issues, and the burden on the parties and on the court system of this kind of litigation, in our view, is not justified by any corresponding social benefit.

More than any other provision of RICO, the general availability of treble damages in RICO actions is what gives private civil RICO its extortive force. By narrowing the range of private civil RICO cases in which such treble damages may be recovered, S. 1523 takes a significant step toward curbing abuse of the private civil RICO action.

As you know, the bill provides that in the most common private civil RICO actions only actual damages may be recovered, and thus in these cases the bill would serve to eliminate the primary incentive for initiating the most abusive and extortive suits.

The change proposed by S. 1523 in this respect would not deprive plaintiffs of any other relief to which they may be rightfully entitled because make-whole relief, of course, which is still available, is the norm in most civil cases.

So, as indicated, while we believe that civil RICO as it stands now has a number of substantive shortcomings—and we have at-

tached to our statement and I would request that it be incorporated into the record, a letter to Congressman Conyers which indicates some of these additional shortcomings.

Mr. CORREIA. It will be entered into the record.

Mr. DUBESTER. But as we also discuss, our experience indicates that a good deal of the tactical misuse of the present private civil RICO action is motivated by the availability of treble damages.

So we believe the narrowing of that availability which is provided in S. 1523 is a salutary one and we would urge this Committee to enact some kind of measure like S. 1523 which accomplishes that objective.

Thank you.

Mr. CORREIA. Thank you.

[Statement follows:]

TESTIMONY OF ERNEST DUBESTER, LEGISLATIVE REPRESENTATIVE,
AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS,
BEFORE THE SENATE COMMITTEE ON JUDICIARY
ON S. 1523,
A BILL TO AMEND THE CIVIL PROVISIONS OF THE
RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT (RICO)

October 29, 1987

I appreciate this opportunity to present the views of the AFL-CIO in support of S. 1523.

The AFL-CIO believes this bill would accomplish one significant and necessary step toward curbing the current rampant abuse of the private civil RICO action: the narrowing of the class of private civil RICO actions in which treble damages may be recovered by a plaintiff. For that reason, while we believe other reforms of the private civil RICO action are also needed, we urge the Committee to give favorable consideration to S. 1523.

At the outset, we believe Section 2 of the bill takes the proper approach in addressing the peculiar problems posed by private civil RICO actions separately from issues respecting criminal prosecutions under RICO and civil RICO actions brought by governmental authorities.

RICO's substantive provisions were fashioned in the broadest terms to provide federal law enforcement authorities a means through the criminal laws to reach organized crime and its assets. The net was cast as wide as possible, with the safeguard against abuse being the responsible use of prosecutorial discretion. That safeguard is not available in the context of private civil litigation. Whatever the wisdom of placing such broad power in the hands of governmental authorities, experience has shown that placing the same power in the hands of private parties whose objective is to further their own interests, not the interest in coherent and effective law enforcement, produces results that are both destructive to innocent parties and contrary to the goals RICO was intended to accomplish.

The AFL-CIO has had perhaps a unique opportunity to observe how the private civil RICO action actually works. Unions affiliated with the AFL-CIO have been both

plaintiffs and defendants in such suits which are now arising in the labor dispute context, as employers and unions add the private civil RICO action to the arsenal of weapons available for use in such disputes. The experience to date teaches the following lessons.

Private civil RICO actions rarely, if ever, are brought to attack the core conduct that concerned Congress in enacting RICO. Congress' motivating objective was to end the infiltration of legitimate institutions by organized crime. The AFL-CIO supports that objective. But few if any private civil RICO actions even purport to address such infiltration. The typical private civil RICO action is between parties to ordinary commercial disputes and labor disputes in which the parties have no relation to organized crime. See Sedima, S.P.R.L. v. Imrex Co., ___ U.S. ___, 105 S.Ct. 3275 (1985) (dispute over billing practices in joint venture); see also, e.g., Adair v. Hunt International Resources Co., 526 F. Supp. 736 (N.D. Ill. 1981) (land investment fraud). In that setting, the private civil RICO action offers a party a broad-ranging, open-ended means of attack carrying drastic monetary and other remedies, as a substitute for the more carefully limited state and federal causes of action specifically addressed to the kinds of misconduct that such disputes sometimes engender. See, e.g., Parnes v. Heinold Commodities, Inc., 487 F. Supp. 645 (N.D. Ill. 1980) (circumventing limited remedial provisions of the Commodities Exchange Act). As Justice Marshall put it in his dissent in Sedima, 105 S. Ct. at 3295:

Only 9% of all civil RICO cases have involved allegations of criminal activity normally associated with professional criminals. The central purpose that Congress sought to promote through civil RICO is now a mere footnote. [Emphasis added.]

Indeed, in Sedima, though they disagreed on questions of statutory interpretation, all nine justices agreed that, in the words of the Court majority, "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors," 105 S. Ct. at 3302, and in the words of Justice Powell, in dissent, that "RICO has been interpreted so broadly that it has been used more often against respected businesses with no ties to organized crime, than against the mobsters who

were the clearly intended target of the statute." *Id.* at 3289. The majority in *Sedima* made clear, however, that "correction [of the statute] must lie with Congress." 105 S. Ct. at 3287.

As would be expected from the nature of the private civil RICO suits that are being brought, their actual results serve none of RICO's overriding objectives. Because of that Act's vague and complex substantive provisions and its far-reaching remedial provisions, the private civil RICO action is the ideal "strike suit." As Justice Marshall stated in *Sedima*, 105 S. Ct. at 3295:

In practice, [the private civil RICO] provision frequently has been invoked against legitimate businesses in ordinary commercial settings Many a prudent defendant, facing ruinous exposure, will decide to settle even a case with no merit. It is thus not surprising that civil RICO has been used for extortion purposes, giving rise to the very evils that it was designed to combat.

Our experience confirms that a private civil RICO action can be an all too effective means of coercing a settlement from a defendant who is unwilling to endure the embarrassment, the litigation expense and the risk of devastating penalties inherent in defending a civil RICO suit. Where a private civil RICO action does not result in a quick settlement, the consequences are likely to be undesirable for all involved: litigants on both sides become trapped in an unmanageable morass of complicated factual and legal issues. The burden on the parties and on the court system of this kind of litigation is not justified by any corresponding social benefit.

In addition, more than any other provision of RICO, the general availability of treble damages in RICO actions is what gives private civil RICO its "extortive" force, see *Sedima, supra*, 105 S. Ct. at 3295. Particularly in the context of a statute containing broad and vague definitions of prohibited conduct, the threat of a treble damages award forces even the innocent defendant to consider seriously and often accede to demands for substantial monetary "settlements." And the knowledge that defendants will react in that fashion is what induces many private civil RICO actions.

By narrowing the range of private civil RICO cases in which treble damages may be recovered, S. 1523 takes a significant step toward curbing abuse of the private civil

RICO action. The bill provides that, in the most common private civil RICO actions, only actual damages may be recovered. Thus, in these cases, the bill would serve to eliminate the primary incentive for initiating "strike suits." Nor would the change proposed by S. 1523 deprive plaintiffs of any relief to which they may be rightfully entitled. Make whole relief, which of course still would be available, is after all the norm in civil cases. Legitimate private plaintiffs would lose only the windfall of monetary awards in excess of the losses they actually suffered.

We believe that civil RICO as it stands now is infected by a number of substantive shortcomings. For reasons developed at length in the attached letter to Congressman Conyers, we continue to urge that those shortcomings be corrected. But, as we have discussed, experience to date shows that a good deal of the tactical misuse of the present private civil RICO action is motivated by the availability of treble damages. Therefore, we commend the narrowing of that availability provided in S. 1523. Thank you.

American Federation of Labor and Congress of Industrial Organizations



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October 11, 1985

The Honorable John Conyers, Jr.
Chairman
Subcommittee on Criminal Justice
of the House Committee on the
Judiciary
2237 Rayburn House Office Building
Washington, D.C. 20515

Re: Hearings on H.R. 2517 and H.R. 2943: Bills to Amend
the Racketeer Influenced and Corrupt Organizations
chapter of Title 18, United States Code, 99th Cong.,
1st Sess.

Dear Chairman Conyers:

The American Federation of Labor-Congress of Industrial Organizations (AFL-CIO) hereby requests that its views respecting the private civil liability provisions of the Racketeer Influenced and Corrupt Organizations provisions of the criminal code, set out below, be included in the record of the above noted hearings.

The AFL-CIO has had perhaps a unique opportunity to observe how the private civil RICO action actually works. Unions affiliated with the AFL-CIO have been both plaintiffs and defendants in such suits which are now arising in the labor dispute context, as employers and unions add the private civil RICO action to the arsenal of weapons available for use in such disputes. The experience to date teaches the following lessons.

First, private civil RICO actions rarely, if ever, are brought to attack the core conduct that concerned Congress in enacting RICO. Congress' motivating objective was to end the infiltration of legitimate institutions by organized crime. The AFL-CIO supports that objective. But few if any private civil RICO actions even purport to address such infiltration. The typical private civil RICO action is between parties to run of the mine commercial disputes and labor disputes, in which

The Honorable John Conyers, Jr.
 October 11, 1985
 Page 2

the parties have no relation to organized crime. See Sedima, S.P.R.L. v. Imrex Co., ___ U.S. ___, 105 S. Ct. 3292 (1985) (dispute over billing practices in joint venture); see also, e.g., Adair v. Hunt International Resources, Co., 526 F. Supp. 736 (N.D. Ill. 1981) (land investment fraud). In that setting, the private civil RICO action offers a party a broad ranging, open ended means of attack carrying drastic monetary and other remedies, as a substitute for the more carefully limited state and federal causes of action specifically addressed to the kinds of misconduct that such disputes sometimes engender. See e.g., Parnes v. Heindol Commodities, Inc., 487 F. Supp. 645 (N.D. Ill. 1980) (circumventing limited remedial provisions of the Commodities Exchange Act). As Justice Marshall put it in his dissent in Sedima 105 S. Ct. at 3295:

Only 9% of all civil RICO cases have involved allegations of criminal activity normally associated with professional criminals. The central purpose that Congress sought to promote through civil RICO is now a mere footnote. [Emphasis added.]

Indeed, the majority of the Court in Sedima, while giving civil RICO a broad construction and holding that "correction [of the statute] must lie with Congress," went on to "recognize that, in its private civil version, RICO is evolving into something quite different from the original conception of its enactors." 105 S. Ct. at 3287.

Second, as would be expected from the nature of the private civil RICO suits that are being brought, their actual results serve none of RICO's overriding objectives. Because of that Act's vague and complex substantive provisions and its far reaching remedial provisions, the private civil RICO action is the ideal "strike suit." As Justice Marshall stated in Sedima, 105 S. Ct. at 3295:

In practice, [the private civil RICO] provision frequently has been invoked against legitimate businesses in ordinary commercial settings. . . . Many a prudent defendant, facing ruinous exposure, will decide to settle even a case with no merit. It is thus not surprising that civil RICO has been used for extortive purposes, giving rise to the very evils that it was designed to combat.

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From what we have seen, a private civil RICO action can be an all too effective means of coercing a settlement from a defendant who is unwilling to endure the embarrassment, the litigation expense and the risk of devastating penalties inherent in defending a civil RICO suit.

Third, where a private civil RICO action does not result in a quick settlement, the consequences are likely to be undesirable for all involved: litigants on both sides become trapped in an unmanageable morass of complicated factual and legal issues. The burden on the parties and on the court system of this kind of litigation is not justified by any corresponding social benefit.

For the foregoing reasons the AFL-CIO urges several changes in the civil RICO provisions:

1. We support enactment of legislation along the lines of H.R. 2943. That bill would curb what we regard as the dangerous practice of in effect placing in private hands the prosecution of public crimes. Requiring a criminal conviction for racketeering activity as a prerequisite to a private civil suit would, moreover, deter some vexatious suits and would also end the confusion over the standard of proof to be applied to the predicate crime elements of a civil RICO action. See Sedima, 105 S. Ct. at 3283.

We agree, however, with S.E.C. Chairman Shad that the language of H.R. 2943 should be clarified. The amendment's references to "such conduct" and "with respect to the conduct out of which such action arises" leave it unclear whether the plaintiff must allege that he was harmed by the specific actions upon which the defendant's conviction is based, or whether it is sufficient to have standing to allege harm caused by other asserted, but so far unproven, racketeering activities of the defendant. We would favor language that makes it clear that the plaintiff must have been harmed by the criminal conduct that is the basis of the conviction. Moreover, H.R. 2943's proposal that a conviction for "racketeering activity" be a prerequisite to bringing a civil suit could be understood to mandate either that there be a prior conviction on one of the predicate crimes which define "racketeering activity" or that there be a prior conviction on crimes sufficient to constitute a "pattern of racketeering activity." To clarify this point the bill should specify that for a civil suit to lie there must be prior convictions of crimes that

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constitute a "pattern of racketeering activity" as defined in 18 U.S.C. §1961(5).

2. We join the A.B.A., the SEC, and the others who have urged that there are more fundamental deficiencies in the private civil RICO action that must be corrected.

The basic problem with the civil RICO action lies in the breadth and vagueness of the substantive standards governing the cause of action. RICO's substantive provisions were fashioned to provide federal law enforcement authorities a means through the criminal laws to reach organized crime and its assets. The net was cast as wide as possible, with the safeguards against abuse being the responsible use of prosecutorial discretion. Congress thereafter added to the Act the private civil action. Whatever the wisdom of placing such unbridled power in the hands of federal prosecutorial authorities -- a matter which we strongly urge this subcommittee to consider at the earliest appropriate time -- placing the same power in the hands of private parties whose objective is to further their own interests, not the interest in coherent and effective law enforcement, is we believe, reckless in the extreme.

The following proposed amendments to the substantive provisions governing private civil RICO actions would limit the opportunities for abuse of such actions without diminishing the potential for such actions to serve their intended purposes.

a. (1) Because RICO is directed at combatting a pattern of criminal conduct, the definition of a "pattern of racketeering activity" is the conceptual center of the Act. As presently drafted, a plaintiff may establish "a pattern of racketeering activity" by proving that the defendants engaged in conduct constituting certain specified predicate offenses at least two times; one of these offenses need have occurred after the effective date of the Act, but, apparently, the other can have occurred at any time. A plaintiff may thus seek to prove his case by showing conduct constituting an offense occurring as many as ten, twenty or thirty years before the suit was brought. For all the reasons that we have statutes of limitations, such a result is unacceptable. No defendant can be expected to be able adequately to defend against a charge that he committed a crime of such ancient vintage. Witnesses may have died, documents may have long since been destroyed or lost, and memories in any event will have faded -- few among us

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can remember what we were doing on a particular day two or three years ago, much less twenty or thirty years ago.

The proposed amendment contained in H.R. 2517, subparagraph (3), would resolve this problem in the criminal context by requiring that both predicate crimes occur within five years of the time the indictment is returned. By analogy, we suggest that for the purposes of civil RICO the Act should be amended to require that the predicate crimes occur within five years of the filing of the complaint. To so limit the action is not to deprive the plaintiff of anything he should have. If the plaintiff cannot show at least two acts of "racketeering activity" occurring within the limitations period, one may properly question whether there is in fact a "pattern" of such activity.

(ii) The definition of "pattern of racketeering activity" should be amended in a second respect as well. The present definition does not specify what if any connection there must be between the predicate acts; it is not clear at what point distinct acts of criminal conduct are to be deemed to constitute a "pattern." See, e.g., United States v. Elliot, 571 F.2d 880, 889 & n.23 (5th Cir.), cert. denied, 494 U.S. 953 (1978). To cure this defect, we urge the adoption, for the purposes of civil RICO, of the language in paragraph (3) of H.R. 2517 requiring that the predicate criminal acts be "interrelated by a common scheme, plan, or motive, and . . . not isolated events." This amendment would give content to the requirement that the acts truly constitute a "pattern."

(iii) At present it is possible to base a RICO claim on two predicate act violations arising out of a single transaction involving, for example, several fraudulent mailings. See, e.g., United States v. Weatherspoon, 581 F.2d 595, 601 (7th Cir. 1978). Indeed, nearly half of private RICO actions have been based on a single episode involving a single victim. See Statement of Deputy Assistant Attorney General John C. Keeney on RICO Legislation before the House Judiciary Subcomm. on Criminal Justice, 99th Cong., 1st Sess. 24 (Sept. 18, 1985). A single episode of wrongdoing simply does not constitute a "pattern of racketeering" in any meaningful sense of that concept. The present interpretation to the contrary expands the application of RICO far beyond what the objectives of the Act justify. Subparagraph (3) of H.R. 2517 proposes to solve this problem by amending the definition of "pattern" to require that the two predicate acts be "separate in time and

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place." This provision should be adopted for the purposes of civil RICO.

b. The term "conduct or participate . . . in the conduct of [an] enterprise" found in 18 U.S.C. § 1962(c) should be defined to mean "to manage in a supervisory capacity the enterprise's basic functions so as to further the enterprise's financial interests." The need to add such a definition is demonstrated by such cases as United States v. Ladner, 429 F. Supp. 1231 (E.D. N.Y. 1977). It is certainly tenable to condemn as a racketeering enterprise an organization that is perverted into an instrument of wrongdoing against outside individuals or other organizations. That appellation does not fit an accumulation of offenses by an organization's employees which do not infect the basic character of the enterprise. A pattern of such wrongdoing may identify an individual as a racketeer, but it is plainly insufficient to identify an organization as a racketeering enterprise. As the Ladner court stated, 429 F.Supp. at 1244, RICO "is concerned with that which characterizes the conduct of the enterprise in question in its essential functions rather than irregularities committed in the course of the otherwise lawful conduct of an enterprise." See also United States v. Dennis, 458 F.Supp. 197 (E.D. Mo. 1978). Similarly, where officers or employees of an enterprise victimize their own enterprise by theft or similar misdeeds, they are not perverting or abusing the power of the enterprise -- the proper concern of RICO -- but merely taking advantage of the enterprise. The enterprise is the victim. In the same vein, an enterprise can not be perverted from the bottom. The language suggested above thus speaks of "manag[ing] in a supervisory capacity" to further ensure that the reach of the Act is limited to those persons whose conduct accurately may be said to "characterize" the essential nature of the enterprise.

* * *

In Sedima, though they disagreed on questions of statutory interpretation, all nine justices agreed that, in the words of the Court majority, "in its private civil version, RICO is evolving into something quite different from the original conception of its enactors," 105 S. Ct. at 3302, in the words of Justice Powell, in dissent, that "RICO has been interpreted so broadly that it has been used more often against respected businesses with no ties to organized crime, than against the mobsters who were the clearly intended target of the statute," id. at 3289, and in the words of Justice Marshall, that the

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statute is now "being used for extortive purposes, giving rise to the very evils that it was designed to combat," id. at 3295. Each of the suggested amendments to the civil RICO provisions set out above would, without impairing the Act's salutary anti-racketeering purposes, focus RICO on its intended target while eliminating its potential for misuse by the parties to ordinary commercial and labor disputes who seek to gain an unfair advantage by bringing civil RICO actions.

Sincerely,

Laurence Gold / *ll*
Laurence Gold
General Counsel

LG/ll

Mr. CORREIA. Mr. Califa.

Mr. CALIFA. Thank you, Mr. Correia. The ACLU has submitted extensive written testimony and we respectfully ask that it be included in the record.

Mr. CORREIA. It will be entered in the record.

Mr. CALIFA. Thank you.

Thank you for inviting us here today to testify concerning the issue of civil RICO reform. We recognize the need for such reform and welcome the efforts of Senator Metzenbaum toward prompt enactment of legislation.

As you know, the private right of action under RICO has become a routine aspect of federal civil litigation. An individual may recover automatic treble damages plus costs and attorney's fees if he can show that he was injured in his business or property through a pattern of racketeering activity. The plaintiff must also show that this injury occurred by and through an enterprise through which the defendant acted to injure him.

Despite the general recognition that Congress originally intended RICO to apply only to those activities of those engaged in organized crime, the statutory definitions of enterprise and pattern of racketeering activity were worded in such a way as to allow for very expansive application. Pattern of racketeering activity is defined in a similarly broad fashion.

Beginning in the early 1980's, certain Federal courts began to consider ways through which the unintended expansion of civil RICO could be contained. In a watershed decision, the Supreme Court in *Sedima* in 1985 eliminated many of the limitations that the lower courts had attempted to impose on civil RICO.

The Court in *Sedima* said, quote, "RICO is evolving into something quite different from the original conception of its enactors." The Court nevertheless held that the defect that had caused this expansion "is inherent in the statute as written and its correction must lie with Congress," and I think that is the activity we are engaged in today.

The statute's tremendous reach has also not been remedied by courts because they have recognized the salutary uses that RICO has had in combatting organized crime. Because the same statutory language that governs the scope of civil RICO also governs the statute's criminal applications, courts have been reluctant to limit the statute's civil applications for fear that in so doing they may inadvertently restrict federal prosecutors' ability to fight organized crime.

The inevitable result has been a trend among the private bar to experiment with civil RICO in an increasingly broad range of situations far removed from those associated with organized crime activities, ranging from libel and slander to labor-management disputes and to ideological confrontations, and it is this latter category that especially concerns the American Civil Liberties Union.

We are concerned because civil RICO can and has been used against people and organizations involved in advocacy. The potential for chilling First Amendment rights is enormous. Let me provide an example.

A member of a large advocacy organization commits two acts that are punishable under RICO. Presently, RICO would allow

plaintiffs in their complaint to attribute these two criminal acts to others who were associated with the advocacy organization but who had no part in the criminal activities.

So in my example we would have the two nonculpable defendants charged in the complaint with being racketeers and involved with a corrupt organization. Plaintiffs could engage in extensive discovery as to associational ties. The threat of treble damages and payment of plaintiff's costs and attorney's fees would also be present.

RICO used against political and advocacy groups in this way has a chilling effect. This is so even if the defendants ultimately prevail and get the claim dismissed. So, therefore, we are especially pleased to support the provisions in S. 1523 which require that claims as to each defendant be stated with particularity.

This provision requires that the facts supporting allegations in a complaint be stated with particularity as to each defendant. We think that this would certainly meet our concerns that people who are not engaged in predicate activity be spared the expense of litigation.

I would like to note briefly other changes in the bill that make needed reforms in civil RICO. The proposal would narrow the instances where treble damages could be awarded. No longer could the punitive damage rule be routinely used.

Finally, we believe eliminating the term "racketeer" is beneficial.

Because of our concern for civil liberties, we urge immediate and favorable consideration of this important legislation. We commend Senator Metzenbaum for his leadership in this area, and thank you for allowing us to testify today.

Mr. CORREIA. Thank you, Mr. Califa.

[Statement follows:]

STATEMENT OF

ANTONIO J. CALIFA, LEGISLATIVE COUNSEL

AMERICAN CIVIL LIBERTIES UNION
WASHINGTON OFFICE

ON BEHALF OF

THE AMERICAN CIVIL LIBERTIES UNION

ON

S.1523

REFORM OF THE RACKETEER INFLUENCED
AND CORRUPT ORGANIZATIONS ACT OF 1970

BEFORE

UNITED STATES SENATE
COMMITTEE ON THE JUDICIARY

October 29, 1987

Mr. Chairman and Members of the Committee:

Thank you for allowing me to come before you today on behalf of the more than 250,000 members of the American Civil Liberties Union (ACLU). The ACLU strongly supports reform of the civil provisions of the Racketeer Influenced and Corrupt Organizations Act of 1970, 18 U.S.C. Secs. 1961-1968 (RICO). We applaud Senator Metzenbaum's efforts to reform civil RICO and commend Senator Biden for calling these hearings. We appear here today to encourage prompt passage of RICO reform legislation.

Background

The declared purpose of Congress in enacting the RICO statute was "to seek the eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime." 116 Cong. Rec. 35,191 (1970) (Statement of Rep. Sisk). Senator McClellan stated that the purpose of RICO was to provide "a major new tool in extirpating the baneful influence of organized crime on our economic life." 116 Cong. Rec. 25190 (1970). Indeed, organized crime's activities were growing in scope and number, thus stimulating strong bi-partisan fervor for additional statutory methods to combat its continued expansion.

Of particular importance to sponsors of the Act was organized crime's increased infiltration of legitimate business. (See 84 Stat. 922-923). Appearing before this same body in January of 1970, Lawrence Speiser, then director of the Washington headquarters of the ACLU, stated, "we strongly endorse

governmental efforts to stop the activities of organized crime which so adversely affect our society," but continued, "that these efforts must not evade constitutional safeguards available to all under our system of government." Moreover, the ACLU warned that RICO might be utilized, "in times of stress, or where the aim seemed laudable .. in areas far removed from what we know as organized crime." (testimony before the Senate Judiciary committee, January, 1970, 490).

Apprehension regarding the new statute's breadth was not restricted to the ACLU. Congressman Mikva warned that "the spread of the shotgun approach will involve a lot of activities not intended to be covered and will not be successful in addressing itself to the problems that were intended to be covered ... The overreach, the looseness of the language, the whimsy of this bill just simply does not enhance the legislative process." 116 Cong. Rec. 35205 (1970). Unfortunately, it appears these concerns have been manifested. In the landmark case of Sedima S.P.R.L. v. Imrex, 473 U.S. 479 (1985), the Supreme Court stated that RICO is being used for purposes far different from those envisioned in 1970. To date, though the Justice Department has used restraint in availing itself of RICO's sweeping provisions, civil RICO has become a favorite tool of the private bar. With enticements including federal court access, treble damages, attorney's fees, costs, and the label "racketeer" affixed to the defendants, the number of civil suits initiated under RICO has quadrupled since 1982. (New York Times, Sept. 24, 1986, at A17.)

Legislative History

The utter paucity of legislative history on civil RICO clearly suggests that the civil provisions of RICO were hastily conceived. The civil measures of RICO were a legislative afterthought, not included in the Senate version of the bill instead, tacked on later in the House bill and agreed to by the Senate without conference. See, Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 507 (1985). While its purported purpose was to allow victims of organized crime to readily seek financial redress, and to financially punish organized crime, its current application is more likely to involve "garden variety" fraud cases against reputable businesses, and against political organizations rather than against the "mob" enterprises envisioned by Congress.

Current Statutory Provisions

As currently codified, the RICO statute makes four types of conduct unlawful. Generally, it is unlawful to: (1) use or invest income derived from a pattern of racketeering to acquire an interest in an enterprise engaged in or affecting interstate commerce; (2) acquire or maintain an interest in any such enterprise through a pattern of racketeering activity; (3) conduct or participate in the affairs of such an enterprise through a pattern of racketeering activity; or (4) conspire to violate any of the foregoing provisions. 18 U.S.C. Sec. 1962. With respect to each type, the plaintiff must show the existence of an "enterprise," the concept of which is somewhat amorphous, and establish a "pattern" of racketeering activity constituted by commission of at least two predicate crimes within a ten-year period. See 18 U.S.C. Sec. 1961(4); see also U.S. v. Turkette,

452 U.S. 576, 583 (1981). Predicate acts include not only such traditional organized crime activities as murder and arson, but also obstruction of justice and other crimes chargeable under state laws and punishable by imprisonment for more than one year. As to remedies, "any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefor in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee." 18 U.S.C. Sec. 1964(c) (1970). To prevail in a civil RICO action, a plaintiff must prove his claim by a preponderance of the evidence, a level of proof that is certainly less demanding than "clear and convincing" or "beyond a reasonable doubt." Denied criminal law's procedural protections, its heightened burden of proof, nor requiring a conviction of the underlying predicate activities, the defendant in a RICO action is subject to threefold the actual damages.

Because of the treble damages and its expansive applications, civil RICO has become increasingly fashionable and flexible. Civil RICO has become an unbridled weapon for the private litigator. Often, the mere threat of treble damages and being labeled a "racketeer," intimidates defendants into settlement in even the most frivolous suit. Because RICO is "a sweeping act which intrudes on state power and has great potential for abuse against individual defendants," (see Atkinson, 65 J. Crim. L. and Criminology (1978)) the courts began to impose judge-made restrictions on civil RICO, hoping that, by

circumscribing its application, they might limit its abuses.

Sedima

However, the United States Supreme Court, in Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479 (1985), eliminated much of the intercircuit conflict over RICO, thereby sweeping away many of the judicially imposed restrictions on the statute's scope. First, the Court rejected lower court decisions requiring conviction of a predicate offense, ruling that a racketeering activity need only be subject to criminal sanctions, and that holding otherwise would contravene the statute's legislative purpose. Id. at 489. Second, the Court ruled that a plaintiff need not suffer an injury separate and distinct from the injury caused by the underlying activity, stating specifically that,

"if the defendant engages in a pattern of racketeering activity in a matter forbidden by these provisions, and the racketeering activities injure the plaintiff in his business or property, the plaintiff has a claim under sec 1964(c). There is no room in the statutory language for an additional, amorphous 'racketeering injury' requirement."

Id. at 497. Furthermore, in dicta, the Court dismissed imposition of a higher burden of proof for the prerequisite criminal activities.

A 5-4 decision, the Court hardly endorsed the statute. On the contrary, though failing to judicially refocus RICO, the Court opined, "This defect--if defect it is--is inherent in the statute as written, and its correction must lie with the Congress." Id. at 499. Voicing its recognition that, in its private civil version, RICO has evolved into something manifestly askew from the original conception of its creators, the Court nevertheless deferred to the wisdom of Congress to correct the

statutory inadequacies. *Id.* at 500.

Civil Liberties Concerns

The ACLU believes that the bill proposed by Sen. Metzenbaum corrects many of the deficiencies in existing RICO law with which we are concerned. Our particular concerns are with regard to the chilling effect on political organizations' First Amendment rights rendered by the mere initiation of a suit under civil RICO. Among the changes we applaud are the stricter pleading requirements, narrowing of the availability of treble damages by requiring, in certain applications, conviction of underlying predicate activity, changing the level of proof from preponderance to clear and convincing with regard to punitive damages, and elimination of the pejorative term "racketeer." We believe that these changes will provide the courts with the legislative guidelines they need to correct the abusive civil provisions of RICO.

The ACLU is committed to the vigilant defense and protection of the Bill of Rights. Perhaps the most sacred of these rights, and of paramount importance in the minds of the drafters of the Constitution, are those embodied in the First Amendment. Civil RICO, in its tolerance for a tenuous link between the criminal acts of one person involved in criminal activity and organizations involved in protected activity, chills the rights protected by the First Amendment. The ACLU abhors the "guilt by association" capabilities engendered in RICO. With pattern and enterprise so loosely defined, liberal pleading requirements easily satisfied, implication by association, the specter of treble damages, costly defense, intrusive discovery, and the

"racketeer" label, civil RICO seriously impinges First Amendment privileges.

Indeed, the Supreme Court stated "the practice of persons sharing common views banding together to achieve a common end is deeply embedded in the American political process ... by collective effort individuals can make their views known, when, individually their voices would be faint or lost." Citizens Against Rent control/Coalition for Fair Housing v. City of Berkeley, 454 U.S. 290, 294 (1981). The Court has long protected the marketplace of conflicting ideas and opinions envisioned by the First Amendment.

The most direct threat to this marketplace is created by RICO's facile pleading requirements, which readily subject an organization or individuals, with little relation to the predicate acts or enterprise, to federal treble damages. Simply by connecting two loosely related allegations of criminal activity, the defendant is subject to our judicial system's most severe form of civil remedy. However, we strongly caution against thinking that a judgment is necessary for adversely imputing the civil RICO defendant. On the contrary, the mere onset of litigation provides a serious affront to our First Amendment privileges.

The instant a complaint is filed the adverse party is, under the statute, labeled a "racketeer." Clearly this is not a preferable scenario for an organization which may already be espousing views not shared by the entire community. The prohibitive cost of litigation alone may be enough to cause a

group to cease what should be protected First Amendment behavior. Furthermore, liberal pleading requirements allow a plaintiff to include a loosely associated array of defendants in its claim. Under RICO's expansive provisions and vague language, it is easy for plaintiffs to survive a motion to dismiss, even on strained allegations. This minor obstacle conquered, intrusive discovery proceedings, which may prove particularly damaging to political advocacy groups, soon follow. Indeed, plaintiffs intolerant of a group's opinions, may file suit, realizing their allegations are frivolous, with the sole intention of inhibiting the activities they consider to be an imposition. Our system cannot tolerate such casual use of the courts to achieve political ends through litigation, especially when these ends are not grounded in legitimate allegations.

Plaintiffs bringing suit under civil RICO may do so feeling that it's entirely possible to attribute the criminal activities or racketeering of a particularly overzealous activist to others associated with the same cause, thus permitting suit against a wide range of defendants associated, however remotely, with the same activist enterprise. While the group or individuals responsible for the criminal activities must be sanctioned and condemned, this must not be allowed to impugn the associational rights of related parties. Unfortunately, liberal pleading often allows just such a result.

The ACLU believes that civil RICO's potential, for chilling First Amendment rights, is enormous. The most notable manifestation of this has been in the abortion clinic context. Here, there have been at least three cases where clinics have

used civil RICO to sue people who were engaged in protected First Amendment activities. (See generally Feminists Women's Health Center v. Dottie Roberts (W.D. Wash.), Northeast Women's Center, Inc. v. McMonagle (E.D. Pa.), Portland Feminists Women's Health Center v. Advocates for Life (Ore. Cir. Ct.).)

Unfortunately, it is not necessary for the plaintiffs in this type of case to prevail in a final judgment before severe damage is inflicted on the defendants. Simply by filing a claim, the plaintiffs stigmatize the anti-abortion activists as "racketeers," often forcing a wide array of defendants, or an entire organization, to retain counsel no matter how frivolous the allegations. Rule 11 of the Federal Rules of Civil Procedure, which requires that attorneys sign only those pleadings that they believe in good faith to be true, is supposed to guard against frivolous lawsuits. Rule 11 is inadequate protection. In fact, the mere threat of a RICO claim, with its treble damages, may be enough to preempt an organization from activities normally thought to be covered by the First Amendment's protective umbrella.

RICO Reform

S.1523 will curb the First Amendment abuses engendered in current RICO law, while preserving its ability to carry out its intended purpose, namely the eradication of organized crime's infiltration of legitimate business. The bill would discourage the filing of groundless suits by circumscribing the situations under which a legitimate action may be brought.

Of crucial concern to the ACLU is an amendment to RICO's

liberal pleading requirements. Senator Metzenbaum's legislation would require a plaintiff, seeking redress under RICO, to aver with particularity the facts which support the plaintiffs claim against each defendant named in the action. S.1523 would provide for the award of attorney's fees to an adverse party when the plaintiff asserts frivolous, unreasonable, or groundless claims, or continues to litigate a claim proven to fit into one of the aforementioned categories. We believe these measures will go a long way towards discouraging the filing of claims against defendants having little relation to the actual injury sustained by the plaintiff.

Furthermore, in suits brought by private litigants, the Metzenbaum bill would require a conviction of an underlying unlawful activity, in order to obtain treble damages, and costs including attorney's fees. Under the bill, a plaintiff suing several defendants could only obtain automatic treble damages against the particular defendant convicted of a predicate offense. Without such a measure, defendants are subject to severe remedies for criminal acts without the procedural protections afforded by criminal law, nor its heightened burden of proof. This provision provides needed protection against the drastic remedy or treble damages.

Additionally, a private litigant seeking punitive damages against an unconvicted defendant must first meet several statutory conditions. Namely, the plaintiff must be a natural person, there must be no comparable remedy available under state or federal securities laws, and the plaintiff must show by clear and convincing evidence that the defendant acted in conscious

and wanton disregard of the plaintiff's interests. As to the assessment of punitive damages, the Metzenbaum bill codifies the factors to be considered in making such an assessment, and requires that evidence respecting only punitive damages not be addressed until after a finding of liability.

To alleviate the stigmatization suffered by the party against whom a RICO action is brought, S.1523 changes the term "racketeer" and variants thereof to "unlawful activity" or "criminal." Finally, the bill codifies an affirmative defense to plaintiffs entire claim upon a showing of good faith and reliance on directly applicable regulatory action, approval, or interpretation of law by an authorized state agency. Said affirmative defense would be asserted prior to the commencement of discovery, thereby mitigating the expense of a drawn out litigation.

In sum, the ACLU appears here today to assert its support for the prompt reform of civil RICO as embodied by S.1523. RICO was passed to ameliorate the pervasive affects of organized crime upon society. Civil RICO has strayed from that goal and become a tool, sometimes employed in derogation of our sacred First Amendment rights. The bill restores these rights, lessens the potential that RICO will be used to chill protected rights, still leaving adequate sanctions against organized crime.

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WASHINGTON OFFICE

November 19, 1987

The Honorable Strom Thurmond
 United States Senate
 Committee on the Judiciary
 Washington, D.C. 20510-6275

Dear Senator Thurmond:

Your question regarding the continued necessity of a federal civil RICO remedy, in light of developments in state tort reform and state RICO statutes, while interesting, is outside the particular area of concern of the American Civil Liberties Union. We testified with respect to the civil liberties implications of the federal civil RICO provisions.

Twenty-seven states have, thus far, enacted "little RICO" statutes. We cannot speculate about the ramifications of state RICO legislation. Likewise, we would not attempt to predict how state tort reform factors into this debate. If state RICO statutes prove equally perilous to the First Amendment, the ACLU would certainly encourage their reform. Currently, however, we are concerned with the federal civil RICO statute which, as we stated in our testimony, impacts negatively on civil liberties.

Sincerely,

Antonio Califa
 Antonio Califa
 Legislative Counsel

cc: Senator Metzenbaum

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Mr. CORREIA. Mr. Chiesa.

Mr. CHIESA. Thank you, Mr. Correia. My name is Robert Chiesa and I am a practicing attorney and senior partner in the law firm of Wadleigh, Starr, Peters, Dunn, & Chiesa in Manchester, NH.

I am also the State delegate to the ABA from New Hampshire and a member of the ABA's Standing Committee on Federal Judicial Improvements. Finally, I serve as the Chairman of the Special RICO Coordinating Committee.

The Special RICO Coordinating Committee was appointed in 1968 by Eugene Thomas, then president of the ABA, and was made up of representatives of interested committees and sections of the ABA. These included representatives from the Federal Judicial Improvements Committee and the sections of corporation, banking and business law, litigation, tort and insurance practice, antitrust law, patent, trademark and copyright law, and finally criminal justice, and this composes a great segment of the ABA.

This committee was charged to carefully investigate legislative proposals to amend civil RICO and to recommend a course of action. The coordinating committee unanimously recommended that proposals to amend RICO be endorsed in principle, but also certain amendments which I would like to discuss with you further today.

The ABA House of Delegates approved the special coordinating committee's report and recommendations in the 1987 mid-year meeting, and this testimony therefore represents the official view of the ABA on RICO.

RICO has been an expansive and controversial federal statute and statistics which I was able to find—up until June 30, 1986, there were some 614 civil RICO cases filed. In that same period of time, up until June 30, 1987, that mushroomed to 1,095 cases, an increase of approximately 40 percent.

I would like to say that the ABA supports S. 1523 in principle, and there are a few changes which we would like to see in the final legislation. First of all is the question of punitive damages.

Section 2 of S. 1523 would provide for punitive damages of up to twice the actual damages for certain claimants based upon the weighing of eight enumerated factors, including the degree of culpability, the history of similar conduct, benefits derived, numbers of persons victimized, and any other factor the court deems to be an equitable consideration bearing on the appropriate amount of punitive damages.

We recommend that the term "additional damages" be substituted for the more inflammatory term "punitive damages," and that a judge rather than a jury recommend whether and to what extent such additional damages should be awarded.

We also propose deleting the so-called equitable consideration catch-all factor from the list of factors to be considered in awarding additional damages under this provision.

Judges, who draw upon a history of precedent, are better equipped than individual juries to compare a particular defendant's conduct against the enumerated factors to dispassionately determine if any additional damages should be assessed in any given case.

If judges make this determination, their discretion would be limited to the more objective factors set forth in the proposed section 1964(c)(3) (A) through (G), with the equitable consideration catch-all factor of subsection (H) eliminated to further ensure uniformity of treatment in assessing additional damages.

The second point is the statute of limitations. Proposed section 1964(c)(4) would establish a uniform civil statute of limitations commencing after the latest of three years after the cause of action accrues or the conduct causing injury to the plaintiff terminates, or 2 years after the date of any criminal conviction giving rise to treble damages.

This statute of limitations would replace the judicially created 4-year statute of limitations borrowed from the Clayton Act by the Supreme Court in *Agency Holding Corporation v. Malley-Duff Association, Inc.*, June 22, 1987.

We support a 3-year limitations period tied to the time when the cause of action arises, but suggest that only a one-year period after criminal conviction be permitted to commence suit as otherwise barred.

This is fair because the proposed action section suspends the running of the statute of limitations during the pendency of a governmental civil or criminal case relating to the same conduct.

We recommend that a further provision be added to this section to clarify that a conviction does not become final until after all appellate remedies are exhausted so as not to encourage the filing of civil suits based on a conviction in the trial court which may later be reversed on appeal.

The third point is person and enterprise amendments. Senate bill 1523 fails to address two key issues which have split the lower federal courts in the interpretation of the person and the enterprise requirements under RICO.

Virtually all of the courts which have considered the question have concluded that the same entity cannot be both the person and the enterprise under section 1962(c), and that only the person can be sued for damages.

While the courts have reached almost a unanimous judgment on this issue, there have been two further developments in the case law which have allowed plaintiffs to avoid the holding that enterprises may not be sued for damages. These loopholes are the treatment of affiliated entities as separate persons and enterprises, and the application of ordinary principles of agency or respondeat superior to permit a plaintiff to collect against the enterprise for the acts of a person it employs or with which the person is associated.

It is recommended that Senate bill 1523 be amended to, one, unambiguously require truly separate and nonaffiliated entities to satisfy the person/enterprise duality; and, two, preclude the application of agency and respondeat superior doctrines to permit the collection of a judgment from an enterprise.

If the proposed amendments are incorporated, single firm wrongdoing such as that now routinely attached under RICO in such areas as prime rate computation by banks, churning by securities brokers, and single-firm monopoly or predatory pricing, would be insulated from the application of RICO for lack of the required two entities which RICO clearly contemplated.

Four, conduct amendment; section 1962(c) requires proof that the culpable person "conduct or participate directly or indirectly in the conduct of an enterprise's affairs." As with most RICO issues, the proper interpretation of this conduct requirement has split the courts which have considered it.

Some courts require satisfaction only of a nexus test under which the conduct simply means the performance of activities necessary or helpful to the operation of the enterprise.

Under this approach, banks lending to an unaffiliated enterprise or accountants auditing a client have been held to satisfy this requirement. We believe a better view is that the conduct element requires some policymaking power over the affairs of the enterprise by the defendant, an approach which would insulate accountants and bankers from RICO liability in most cases under ordinary audits and loans.

Finally, the antitrust exemption. Subject to certain exceptions, Senate bill 1523 exempts from the possible award of punitive damages activities for which an express or implied remedy is available either under State law or federal securities laws.

This sensible approach recognizes that the securities laws provide a comprehensive legislative regulatory approach reflecting careful judgments incorporated in amendments to these statutes over the last 50 years, as well as a significant volume of case law in both federal and State courts during much of that period, although the ABA does not have a position on the proposed securities exemption.

The same considerations that militate in favor of not permitting additional damages where an express or implied remedy is available under State or Federal securities laws militate in favor of excluding such damages in the case of antitrust laws.

Like securities laws, the antitrust laws embrace a carefully crafted set of remedies which are designed to foster competition and which have evolved over an even longer period. There should not be an inducement to displace this legislative approach by permitting RICO suits aimed at behavior which falls within the ambit of the antitrust laws.

Mr. Correia, the ABA appreciates this opportunity to appear before you and express our views on the pending RICO legislation. I would be happy to answer any questions if you have any.

[Statement follows:]



AMERICAN BAR ASSOCIATION

GOVERNMENTAL AFFAIRS OFFICE • 1800 M STREET, N.W. • WASHINGTON, D.C. 20036 • (202) 331-2200

STATEMENT OF

ROBERT L. CHIESA

ON BEHALF OF
THE
AMERICAN BAR ASSOCIATION

ON THE SUBJECT OF
PROPOSED AMENDMENTS TO THE
RACKETEER INFLUENCED AND CORRUPT ORGANIZATIONS ACT
(RICO)
S. 1523

BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

OCTOBER 29, 1987

Mr. Chairman and Members of the Committee:

My name is Robert L. Chiesa. I am an attorney and senior partner in the law firm of Wadleigh, Starr, Peters, Dunn & Chiesa in Manchester, New Hampshire. I am the state delegate to ABA from New Hampshire and a member of the ABA Standing Committee on Federal Judicial Improvements. Finally, I serve as Chairmam of the Special RICO Coordinating Committee of the American Bar Association.

The Special RICO Coordinating Committee was appointed by Eugene Thomas, then President of the ABA and was made up of representatives of interested Committees and Sections of the ABA. These included representatives from the Standing Committee on Federal Judicial Improvements, and the Sections of Corporation, Banking and Business Law; Litigation; Tort and Insurance Practice; Antitrust Law; Patent, Trademark and Copyright Law; and Criminal Justice. This Committee was charged to carefully investigate legislative proposals to amend RICO and to recomend a course of action for the ABA.

The Coordinating Committee unanimously recommended that proposals to amend RICO be endorsed in principle, but also recommended further amendments which I would like to discuss with you today. The ABA House of Delegates approved the Special Coordinating Committee's Report and Recommendations at the 1987 Mid-Year Meeting and this testimony therefore represents the official view of the ABA on RICO.

RICO has been an expansive and controversial federal statute which has aroused great debate among courts, litigants, and commentators. While most knowledgeable and concerned observers

have suggested amending RICO, little agreement has been reached as to the scope of appropriate change or clarification of the existing legislation. While the ABA supports S. 1523 in principle, it urges that the following changes be included in the final legislation:

1. Punitive Damages

Section 2 of S. 1523 would provide for punitive damages of up to twice actual damages for certain claimants, based upon a weighing of eight enumerated factors, including degree of culpability, history of similar conduct, benefits derived, numbers of persons victimized, and "any other factor the court deems to be an equitable consideration bearing on the appropriate amount of punitive damages."

We recommend that the term "additional damages" be substituted for the more inflammatory term "punitive damages," and that a judge, rather than a jury, determine whether and to what extent such additional damages should be awarded. We also propose deleting the so-called "equitable consideration" catch-all factor from the list of factors to be considered in awarding additional damages under this provision.

* The Recommendations of the Special RICO Coordinating Committee adopted February, 1987 by the American Bar Association House of Delegates is attached as an Appendix. The Recommendations contained relating to the assessment of attorneys' fees against plaintiffs who litigate groundless claims, and the pleading with particularity of facts supporting the claim against each RICO defendant have been substantially implemented in proposed sections 1964(c)(7) and (8) of S. 1523.

Judges, who draw upon a history of precedent, are better equipped than individual juries to compare a particular defendant's conduct against the enumerated factors to dispassionately determine if any additional damages should be assessed in a given case. If judges make this determination, their discretion should be limited to the more objective factors set forth in proposed section 1964(c)(3)(A)-(G), with the "equitable consideration" catch-all factor of subsection (H) eliminated to further assure uniformity of treatment in assessing additional damages.

2. Statute of Limitations

Proposed section 1964(c)(4) would establish a uniform civil statute of limitations commencing after the latest of three years after the cause of action accrues or the conduct causing injury to the plaintiff terminates, or two years after the date of any criminal conviction giving rise to treble damages. This statute of limitations would replace the judicially-created four-year statute of limitations borrowed from the Clayton Act by the Supreme Court in Agency Holding Corp. v. Malley-Duff Association, Inc., 94 L.Ed 2d 683; 55 U.S.L.W. 3606; 107 S.Ct. 1366 (March 9, 1987).

We support a three-year limitations period tied to the time a cause of action arises, but suggest that only a one year period after a criminal conviction be permitted to commence a suit otherwise time barred. This is fair because proposed section 1964(c)(4)(B) suspends the running of the statute of limitations during the pendency of a government civil action or criminal case

relating to the same conduct. We recommend that a further provision be added to this section to clarify that a conviction does not become final until after all appellate remedies are exhausted, so as not to encourage the filing of civil suits based upon a conviction in the trial court which may later be reversed on appeal.

3. "Person" and "Enterprise" Amendments

S. 1523 fails to address two key issues which have split the lower federal courts in the interpretation of the "person" and "enterprise" requirements under RICO.

Virtually all of the courts which have considered the question have concluded that the same entity cannot be both the "person" and the "enterprise" under section 1962(c), and that only the "person" can be sued for damages.*

While the courts have reached almost a unanimous judgment on this issue, there have been two further developments in the caselaw which have allowed plaintiffs to avoid the holding that enterprises may not be sued for damages. These loopholes are the treatment of affiliated entities as separate persons and enterprises, and the application of ordinary principles of agency or respondeat superior to permit a plaintiff to collect against the "enterprise" for the acts of the "person" it employs or with which the "person" is associated. It is recommended that S. 1523 be amended to (1) unambiguously require truly separate and non-affiliated entities to satisfy the person/enterprise duality,

* See, e.g., Bennett v. United States Trust Co., 770 F.2d 308 (2d Cir. 1985), cert. denied, 106 S.Ct. 800 (1986); B.F. Hirsch v. Enright Refining Co., Inc., 751 F.2d 628 (3d Cir. 1984).

and (2) preclude the application of agency and respondeat superior doctrines to permit collection of a judgment from an enterprise.*

If the proposed amendments are incorporated, single firm wrongdoing such as that now routinely attacked under RICO in such areas as prime rate computations by banks, churning by securities brokers, and single firm monopoly or predatory pricing would be insulated from the application of RICO for lack of the required two entities which RICO clearly contemplated.

4. "Conduct" Amendment

Section 1962(c) requires proof ~~that~~ the culpable person "conduct or ... participate, directly or indirectly in the conduct of [an] enterprise's affairs." As with most RICO issues, the proper interpretation of this conduct requirement has split the courts which have considered it. Some courts require satisfaction only of a nexus test, under which conduct "simply means the performance of activities necessary or helpful to the operation of the enterprise." Under this approach, banks lending to an unaffiliated enterprise, and accountants auditing a client have been held to satisfy the conduct requirement.**

* See the well-reasoned opinion in Schofield v. First Commodity Corp., 793 F.2d 28 (1st Cir. 1986).

** See, e.g., Sun Savings & Loan Association v. Dierdorff, No. 86-5811, slip op. (9th Cir. Aug. 7, 1987); Bank of America National Trust & Savings Association v. Touche Ross & Co., Inc., 782 F.2d 956 (11th Cir. 1986); Virden v. Graphics One, 623 F.2d 1417 (C.D. Cal. 1985).

We believe the better view is that the conduct element requires ~~some~~ policy-making power over the affairs of the enterprise by the defendant, an approach which would insulate accountants and bankers from RICO liability in most cases of ordinary audits or loans. Many courts have held that this is the appropriate test,* and we believe that the goal of S. 1523 to eliminate unfounded RICO suits would be significantly advanced if this amendment were added.

While the exact parameters of this test would require some judicial development, many parallels already exist in such areas as the control liability of banks over borrowers and the control provisions of the federal securities laws. It is suggested that RICO's underlying legislative concern over criminal infiltration of an innocent enterprise requires this narrow construction rather than the liberal nexus standard, which could apply to any third party whose activity facilitates an illegal act, rather than limiting the coverage to one who causes its commission.

5. Antitrust Exemption

Subject to certain exceptions, S. 1523 exempts from the possible award of punitive damages activities for which an express or implied remedy is available under either state or federal securities laws.** This approach recognizes

* See, e.g., Bennett v. Berg, 710 F.2d 1361, 1364 (8th Cir.) (en banc), cert. denied, 464 U.S. 1008 (1983); Plains/Anadarko-P Limited Partnership v. Coopers & Lybrand, 658 F. Supp. 238 (S.D.N.Y. 1987); Agristor Leasing v. Meuli, 634 F. Supp. 1208 (D. Kan. 1986); Hunt v. Weatherbee, 626 F. Supp. 1097 (D. Mass. 1986)

** Proposed section 1964(c)(2)(B)(ii)(II)(bb)

that the securities laws provide a comprehensive legislative regulatory approach reflecting careful judgments incorporated in amendments to these statutes over the last fifty years, as well as in a significant volume of caselaw in both state and federal courts during much of that period.

The same considerations that militate in favor of not permitting additional damages where an express or implied remedy is available under state or federal securities laws militate in favor of excluding such damages in the case of the antitrust laws. Like the securities laws, the antitrust laws embrace a carefully crafted set of remedies which are designed to foster competition, and which have evolved over an even longer period. There should not be an inducement to displace this legislative approach by permitting RICO suits aimed at behavior which falls within the ambit of the antitrust laws.

* * *

Mr. Chairman, the ABA appreciates this opportunity to appear before you today to express our views on the pending RICO legislation.

I will be happy to answer any questions you may have.

* * *

Appendix - American Bar Association RICO Coordinating Committee
Report and Recommendations To The ABA House of Delegates

Approved by ABA House of Delegates,
Midyear Meeting, February, 1987

AMERICAN BAR ASSOCIATION
RICO COORDINATING COMMITTEE
REPORT TO THE HOUSE OF DELEGATES
RECOMMENDATION

BE IT RESOLVED, that the American Bar Association endorses in principle H.R. 5445, as passed by the U.S. House of Representatives, 99th Congress, and similar legislation, to amend the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. sections 1961-68, to limit the availability of a private civil RICO action under the Act and urges inclusion of the following amendments:

1. Additional Damages. (a) Substitute the term "additional damages" for the term "punitive damages", (b) provide that the judge, rather than the jury, shall determine whether additional damages are appropriate and in what amount, and (c) delete the "equitable factor" from the list of factors that are to be considered in determining the amount of additional damages.
2. Attorneys' Fees. Provide that, in business versus business suits, that reasonable attorneys' fees be awarded to a defendant prevailing on the merits of a civil RICO claim if plaintiff's RICO claims are not "substantially justified."
3. Pleading. Delete language amending the Federal Rules of Civil Procedure relating to particularity of pleading. A requirement for particularity should be incorporated in the RICO statute itself.

4. Statute of Limitations. Provide that a civil RICO action ~~cannot be brought~~ after the latest of (1) three years after the date the cause of action accrues or (2) one year after the date of conviction of the defendant of a predicate act or of a RICO criminal prosecution.
5. "Person" and "Enterprise" Amendments. Amend 18 U.S.C. 1962 to:
 - a. Provide that a "person" (1) be a different entity than the "enterprise" under that section, and (2) not be part of an affiliated group whose membership also includes the "enterprise."
 - b. Remove the "enterprise" from liability for treble damages or injunctive relief under the civil provisions of RICO either directly or through the application of principles of agency, respondeat superior, or similar doctrines.
6. "Conduct" Amendment. Amend 18 U.S.C. 1962 (c) to provide that a person may be found to have "conducted" an enterprise's affairs only when such person has actively participated in the operation or management of the enterprise itself.
7. "Antitrust" Amendment. Amend proposed new 18 U.S.C. 1964 (c)(2)(B)(ii)(II) by adding "or antitrust" immediately after "securities."

Mr. CORREIA. There will be no questions at this time. Is it Mr. Chiesa? I think I might have mispronounced your name. Is that correct?

Mr. CHIESA. That is correct.

Mr. CORREIA. All right. Thank you very much. All the witnesses may receive written questions from Senator Metzenbaum or any other member of the Committee, and I appreciate your testimony.

Mr. CALIFA. Thank you.

Mr. DUBESTER. Thank you.

Mr. CORREIA. The next panel is Joan Claybrook, president of Public Citizen; Prof. Michael Goldsmith from Brigham Young University. I think Mr. Engman left. Is that correct?

Ms. CLAYBROOK. In lieu of testifying today we would prefer to return at the same time to testify with Mr. Engman.

Mr. CORREIA. That is your option, fine. I am not sure exactly what arrangements will be made for a statement to be presented, but that is fine.

Professor Goldsmith.

**STATEMENT OF MICHAEL GOLDSMITH, PROFESSOR OF LAW,
BRIGHAM YOUNG UNIVERSITY, PROVO, UT**

Mr. GOLDSMITH. Thank you, Mr. Correia. My name is Michael Goldsmith. I am a professor of law at BYU Law School. I am a former organized crime prosecutor, as well as a former assistant U.S. attorney. I appreciate the chance to be here today and make a few remarks about civil RICO reform.

First, I would like to say that much of the controversy about civil RICO in terms of abuse has been grossly overstated by special interest groups, and that this tendency to overstate has been very carefully documented.

At the same time, there has been evidence of RICO abuse, and I think that the bill that Mr. Metzenbaum has proposed goes a long way towards taking care of the abuse problem. Beyond that, there are other benefits to the bill proposed by Mr. Metzenbaum. In large part, it will go towards legitimizing the use of the RICO statute against white-collar fraud.

The Department of Justice has documented that fraud in America is a \$200 billion problem annually, and clearly we need effective remedies along those lines. These days, the courts are very hostile to civil RICO, and so it seems to me that if we pass a law that specifically authorizes this type of action against white-collar institutions engaged in widespread criminal activity, the hostility of the courts ought to change.

Presently, the courts are so hostile that even good RICO cases involving multi-million-dollar frauds are being rejected by the courts. In addition, one other aspect that may change is that the courts may be more inclined to impose respondeat superior liability on corporations and other principals for the misdeeds of their agents. Presently, the reluctance to do so stems from the fact that triple damages are awarded under RICO. Under your proposal, by virtue of the changes in recovery, the courts may be more inclined to follow traditional practice, which is to impose liability upon principals for the misdeeds of their underlings.

Similarly, I believe that the restrictive holdings by the courts in terms of the pattern element are likely to be done away with as the courts become more reasonable, as they see that Congress has, in fact, sanctioned the use of the RICO remedy. Thus, by legitimizing RICO, you will encourage proper application of the pattern concept.

Nevertheless, I do think there are problem areas with the proposed bill, and let me just point out a few of those for you. Initially, it is ironic and inconsistent that a business victimized by RICO is unable to sue for triple damages. The irony, of course, is that business entities are subject to suit for triple damages, but in the event that they are victimized, they themselves are unable to bring a triple damage action.

The best example I can give you of this irony is a case involving ESM Government Securities, a case involving blatant fraud participation by an accountant, resulting ultimately in a loss of multimillions of dollars, resulting ultimately in the failure of the Homestead Savings Bank in Ohio, the collapse of 71 thrifts in Ohio and elsewhere throughout the country.

None of those victims under the proposed bill would be able to recover for triple damages. Yet, ironically, each of those types of institutions would be subject to a triple damage suit under the RICO statute. It seems to me that a bank, for example, that can be so terribly victimized by fraud ought to be able to bring a suit for triple damages. Historically, the fact is that many of the bank failures in this country have been caused by fraudulent activity by bank insiders, and such criminals ought to be subject to triple damage suits as well.

In addition, one thing that the bill ignores is the fact that although you are trying to represent the interests of the consumer—and Mr. Metzenbaum is on record and for years has tried to represent consumer interests—the fact of the matter is that relatively few consumers, for example, get involved in the stock market. Relatively few consumers get involved in the type of RICO litigation that is really controversial here. Unfortunately, by virtue of the way in which the bill presently is drafted, consumer dollars or small investor dollars invested in pension funds, welfare funds, mutual funds would not be subject to the triple damage suit.

The bill also incidentally ignores the fact that there are many not-for-profit organizations out there that are not natural persons, and I speak now of universities, of hospitals, of nursing homes, of religious organizations, none of which qualify as a natural person, each of which is the potential victim of fraud and ought to get the benefit of a more significant remedy than simply suing to recover for their actual loss.

One proposal that you may consider—and I make reference now to a law review article that appears in the Minnesota Law Review that came out just last April—is the possibility of across-the-board double damages rather than this notion of actual damages for some, punitive damages for others, resulting in a situation where private individuals oftentimes cannot recover for their actual loss because they were only indirectly injured.

In addition, let me make a comment about the prior conviction component of the bill. It is a problem, frankly. First of all, I will correct an error made by another witness earlier today.

Four members of the Supreme Court never endorsed a prior conviction requirement for civil RICO. The dissent in *Sedima* focused on the competitive injury limitation and not on prior conviction. The prior conviction requirement ignores lack of prosecutorial resources. Our Justice Department and State prosecutors are simply swamped.

Now, you are also giving Justice Department prosecutors the right, automatically by convicting someone of RICO, to impose triple damages as well. It seems to me, from a civil libertarian standpoint, that that is too heavy a hammer. It also imposes incentive on the part of so-called victims to go in and make all kinds of allegations, in the hopes of getting a conviction by the Justice Department which they could later leverage into a triple RICO remedy.

Finally, to the extent there is a serious error in this bill, it is the fact that it is retroactive. Retroactivity, of course, is something in a civil context that is very much a subject of Congressional discretion. At the same time, the fact that it is in this particular bill is a good indication of the extent to which special interests have been lobbying over here. The lobbyists have been on record saying that there are billions of dollars of cases out there in terms of potential liability. It clearly makes no sense all of a sudden to say that people who have relied in good faith on the RICO statute ought now to be precluded from relying on that statute by virtue of the passage of this new bill.

I might also add that the argument has been made that many of these cases are frivolous, and the argument has particularly been made by the accounting profession. Well, the truth of the matter is that corporations or companies have been settling RICO cases, on occasion, for millions of dollars and, ladies and gentlemen, you do not settle for multimillions of dollars when the case itself is frivolous. You settle for multimillions of dollars in situations where there has been a very serious fraud.

The final point I have to make, for example, in the context of the ESM case in which there was multi-million-dollar liability—many of the accounting firms there settled for multimillions of dollars and the victims still did not recover their actual damages. So it is very clear here that we need something more than simply actual damages.

Ultimately, I think this is a good bill, and please take my criticisms as proposals for a friendly series of amendments. I urge the Committee and Mr. Metzenbaum, in particular, not to listen to special-interest statements, to look at facts objectively, and, in fact, to take a look at the cases and see to what extent there has been abuse and to see to what extent the anti-RICO arguments have been grossly exaggerated.

I thank you for your time.

Mr. CORREIA. Thank you.

I appreciate the indulgence of all the witnesses and the hearing is adjourned.

[Whereupon, at 4 p.m., the committee was adjourned.]

PROPOSED RICO REFORM LEGISLATION—S. 1523

TUESDAY, NOVEMBER 10, 1987

**U.S. SENATE,
COMMITTEE ON THE JUDICIARY,
Washington, DC.**

The committee met, pursuant to notice, at 3:04 p.m., in room SD-226, Dirksen Senate Office Building, Hon. Howard Metzenbaum presiding.

Senator METZENBAUM. This is a continuation of a hearing on proposed RICO reform legislation. We have two witnesses that we could not hear at the last hearing. This will be a rather abbreviated session. We had a limitation as to the amount of time that our witnesses were allowed originally and the same limits will prevail today.

We are very happy to have Joan Claybrook, president of Public Citizen, here with us, and I understand she is accompanied by Pamela Gilbert and Eric Hard.

It is nice to see you again.

STATEMENT OF JOAN CLAYBROOK, PRESIDENT, PUBLIC CITIZEN, WASHINGTON, DC, ACCOMPANIED BY PAMELA GILBERT, STAFF ATTORNEY, U.S. PUBLIC INTEREST RESEARCH GROUP, AND ERIC HARD, STAFF ATTORNEY, PUBLIC CITIZEN'S CONGRESS WATCH

Ms. CLAYBROOK. Thank you. Mr. Chairman, it is a pleasure to be here this afternoon on behalf of Public Citizen and the U.S. Public Interest Research Group. With me today are Eric Hard, of our Public Citizen's Congress Watch group, and Pamela Gilbert, of the U.S. Public Interest Research Group.

We appreciate the opportunity to appear today to discuss S. 1523, a bill to reduce the civil remedies currently available to victims of organized criminal activity under the Racketeer Influenced and Corrupt Practices Act.

Our organizations are dedicated to preserving and strengthening the remedies available to consumers and others who fall victim to fraud and other white-collar crime. Mr. Chairman, we appreciate the efforts you have made to protect the rights of consumers in so many pieces of legislation over the years, including victims of sophisticated criminal activity to have meaningful access to the courts to seek redress against wrongdoers.

We understand that you have attempted to consider the interests of business that claim that civil RICO is being misused against

them, as well as the interests of the public in fighting white-collar crime that pervades our society.

However, as we will testify, we do not believe that civil RICO lawsuits pose a significant problem to businesses and to individuals that have not engaged in patterns of crime.

The assertion that innocent defendants must settle to avoid treble damage liability suits is questionable since the settlement value of a meritless case can scarcely exceed the value of a final judgment which, according to RICO's opponents, is zero.

RICO, in fact, is an invaluable weapon in the counter-attack against pervasive criminal fraud. We oppose enactment of this legislation because we do not believe a case for taking away this weapon has been made by its business proponents, nor do we believe it can be argued that consumer or business fraud is on the wane.

The Racketeer Influenced and Corrupt Organizations Act provides enhanced penalties for perverse patterns of racketeering behavior conducted in relationship to an enterprise.

The outlawed behavior includes numerous State and federal crimes, such as murder, arson, bribery, prostitution, mail, wire, securities, and bankruptcy fraud. A pattern of criminal behavior is defined in the statute as requiring at least two acts of racketeering behavior committed within ten years of each other.

Section 1964(c) of the statute provides victims of this systemic criminality with a federal cause of action for treble damages, costs, and attorney fees to encourage private enforcement in view of the scarcity of prosecutorial resources. It is these civil provisions that are currently under attack by business interests.

Civil RICO is the consumer's best remedy against white-collar crime and other forms of sophisticated criminal behavior. First, by providing for recovery of attorney's fees, it enables victims who otherwise would not be able to hire an attorney to bring their cases to court. In addition, unscrupulous defendants can very easily increase the cost of litigation so that without attorney's fees, the average person stands little chance of affording such a case.

Second, civil RICO provides for automatic treble damages. These damages serve a deterrent as well as a compensatory function. Without treble damages, the possible punishment if one is caught for engaging in financial crime would be merely returning what was taken.

Discounting the probability of being caught and the likelihood of being sued or found guilty, mere actual damages are not much of a deterrent. If persons considering embarking on a coldly calculated financial racket know that they face automatic treble damages, there is much more of a likelihood that they will refrain from criminal behavior.

In addition, court-awarded damages do not compensate victims for psychological and emotional distress they have suffered, nor do they provide for interest on the money that is stolen. Treble damages help to compensate for these losses as well.

Third, the existence of a federal forum provides necessary procedural benefits to victims of multi-State, systemic criminal behavior. Current law does not require that a State court allow the plaintiffs

in a State scheme to sue out-of-State defendants in one State's court.

Not only could this result deprive victims from being able to receive compensation for their losses, but it may enable the crimes to continue unabated in other States. Furthermore, litigation of these complex criminal schemes would be open to inconsistent rulings on the same facts and would be much less efficient without the ability to bring suit in federal court.

Victims of white-collar crime are often the elderly, the poor, the disabled, and the illiterate, among the most vulnerable members of society and the least able to protect their own interests.

For example, nine plaintiffs sued Atlantic Permanent Federal Savings and Loan claiming that the bank conspired with home improvement dealers in a scheme to obtain second mortgages on lower middle-class homes without the knowledge of the homeowners.

The defendants allegedly targeted elderly, poor, and handicapped people, and it is estimated that 500 to 750 people were victimized by this heinous fraud. The nine named plaintiffs lost their homes as a result of the scam.

Civil RICO enabled these impoverished victims to successfully sue the largest bank in Norfolk, VA, for perpetrating this crime. It is interesting to note that although civil RICO provides for automatic treble damages, the settlement agreement provided less than actual damages to each victim.

Clearly, treble damage liability was important to encourage settlement, but did not result in any kind of windfall gains for any of the parties. It did, however, give these downtrodden people the means with which to vindicate their rights.

In another case, 423 residents of a retirement community successfully sued the mortgagee for participating in a scheme to fraudulently induce them to purchase lifetime occupancy agreements. Many of the plaintiffs invested their life savings to purchase what they believed was a residence to take care of their needs for the remainder of their lives.

Senator METZENBAUM. Joan, can you sort of wind up, please?

Ms. CLAYBROOK. Yes. I am just finishing my next paragraph; that is it.

After \$60 million had been paid into the village, these elderly, ill, and disabled people discovered that the facility had always been financially unsound and faced possible collapse.

The victims of this scam used civil RICO to sue the perpetrators and save them from financial ruin. Under the terms of the settlement agreement, the entire mortgage indebtedness of the village was canceled and more than \$13 million was restored to the victims.

In testimony before the subcommittee of the House of Representatives, an attorney in this case stated, quote, "There is no question in my mind that the results of our lawsuit would not have been attainable were it not for the RICO statute."

Senator METZENBAUM. We will include the balance of your statement in the record.

Joan, I did not know we had three witnesses; I thought we had one witness.

Ms. CLAYBROOK. Well, we split up the testimony. We had put it into one statement, but it is split into three pieces.

Senator METZENBAUM. That is sort of skirting the rules a little bit, the same group coming forward with——

Ms. CLAYBROOK. Well, Pam is from a different group.

Senator METZENBAUM. Pardon?

Ms. CLAYBROOK. Pam actually is from a different organization. Eric is from our own organization.

Senator METZENBAUM. Let me ask you this, Joan. Is it not the fact that the two cases that you described could still be brought under the bill that is pending before us?

Ms. CLAYBROOK. I think Pam should answer that because Pam has researched these cases.

Ms. GILBERT. Yes, Senator Metzenbaum, that is true. Our feeling, however, is that the ability to get automatic treble damages in the current statute is very often what enables impoverished, vulnerable victims, such as the victims in those cases, to effectively bring lawsuits. It makes it attractive enough to an attorney to want to bring those suits because of the potential automatic treble damages.

Senator METZENBAUM. Under my bill, would that not still be possible? You still could get treble damages if the court awarded it.

Ms. GILBERT. That is right, and we are pleased that your bill does give consumers, individual consumers who have been defrauded, the opportunity to get treble damages, and it is very, very important that that remain in the statute.

However, your bill would change current law in that instead of automatic treble damages upon proving a pattern of organized criminal activity on the part of the defendant, a plaintiff would then have to prove by clear and convincing evidence additional elements in order to recover those treble damages, and then again it would be up to treble damages; in effect, a capped punitive damage provision.

Senator METZENBAUM. You do not find any abuse of the system under the present law? As I see it, I do not want to destroy the efficacy of the law, but I also think that there have been some abuses where actions were brought not really for the purpose of litigating, but for the purpose of bringing about a speedy settlement so that a lawyer might get a fee.

Ms. GILBERT. Frankly, Senator Metzenbaum, we have been around for a couple of years hearing those complaints. We have not really seen evidence of it. Our understanding from the Administrative Office of the Courts is that less than one-half of 1 percent of the Federal caseload is civil RICO lawsuits. We do not see it flooding the courts.

Senator METZENBAUM. I am not saying it is flooding the courts, but I am saying in some cases——

Ms. CLAYBROOK. You mean frivolous types of suits; essentially, frivolous suits or suits where there was——

Senator METZENBAUM. Well, you come to see me as the lawyer.

Ms. CLAYBROOK. Right.

Senator METZENBAUM. I see enough to hang my hat on.

Ms. CLAYBROOK. Right.

Senator METZENBAUM. I sue for \$320 million and the big corporation takes it into their law firm and the law firm says what is it going to cost to litigate this matter, and the law firm says probably four, five, six, seven million dollars. We have been told that we may be able to get rid of the case for a million-and-a-half or two. Is it worth doing or should we just litigate the issue?

Ms. CLAYBROOK. Well, I understand that, Senator, but it seems to me that the plaintiff is going to have to pay high attorney's fees, also, and if they have not got much of a chance of recovering, then I do not see how they are going to get an attorney, or if they are they are going to have to pay him out of pocket. So what you are talking about is a pure harassment suit that somebody is willing to pay a lot of money for. We have not seen any evidence.

I think that the concern that we have about this bill is that we have not seen the burden of coming forward made by the proponents of this legislation in terms of frivolous suits or suits brought merely to get attorney's fees, suits for harassment, flooding of the courts, and any of those different charges that have been made.

That is on the one hand, and on the other hand balancing against that we see a huge increase in criminal fraud. We see all sorts of disclosures day after day in the newspapers and we think that an important protection against that is civil RICO because prosecutors simply do not have the resources to enforce the law the way most Americans would like to have the law enforced.

Senator METZENBAUM. Well, there is some major dispute. As you know, the accountants are very strongly against this bill; they think it does not go far enough.

Mr. HARD. Senator Metzenbaum, on that point, the accountants had an opportunity at the October 29 hearing to adduce the evidence of this purported RICO "misuse." I took a look at some of the cases that they produced and I have a few words to say about them, if you would permit me.

Senator METZENBAUM. Briefly, briefly.

Mr. HARD. OK.

Senator METZENBAUM. I would like to go over to hear the President of Israel who is addressing the House at 3:30.

Mr. HARD. Well, that is certainly a very important thing and I would not want to take you away from it.

In what was perhaps the most concrete testimony provided by opponents of civil RICO at the hearing held before this Committee on October 29, the American Institute of Certified Public Accountants cited a handful of cases in support of its contention that, quote, "The level of misuse of civil RICO in fact continues."

The accountants listed eight cases under seven categories which, according to the accountants, are areas in which merely to bring a RICO claim is to engage in misuse. For example, the accountants listed a landlord-tenant dispute.

While the plaintiff was undisputedly a tenant in that case and the defendant a landlord, the plaintiff alleged separate violations of mail fraud and wire fraud. Although the court acknowledged that these allegations might prove true, it nonetheless dismissed the case on pattern grounds.

Thus, to the extent that this case could be viewed as inappropriate, the tools were available to the court to deal with it; that is, it was dismissed.

A second case cited by the accountants, however, involved sexual harassment. This case was a suit against a labor union, including allegations of physical assault, intimidation, loss of employment, and extortion.

While sexual harassment of the plaintiff was unquestionably involved here, the alleged acts committed in furtherance of this goal were precisely the sort of organized criminal conduct against an innocent person that civil RICO was designed to redress.

The court agreed, and held that the plaintiff had stated a valid cause of action under civil RICO for an alleged pattern and practice of sexual discrimination and sexual harassment. The court noted, "It is certainly a reasonable inference from the alleged facts that the defendants acted against Hunt in order to quell any dissension or conflict within the work setting, even at the expense of ignoring a serious assault against one of Local 40's own members. Worse, this particular action against the plaintiff may have simply represented one instance in a longstanding effort"—

Senator METZENBAUM. Instead of reading me that whole statement, just tell me the point of what you are saying.

Mr. HARD. The point is that the accountants came up with a series of cases which—if one examines their facts—represent a far cry from misuse of the civil RICO statute. What they represent are examples of people who have genuine injuries.

For example, they cite a "personal injury" case and say it is a "misuse" of civil RICO to use the statute in such a case. One of the named defendants in this case was an accounting firm. One might ask: What is an accounting firm doing being a defendant in a personal injury case?

The answer is that it was not a personal injury case. What happened was that a person had had her fingers chopped off in a machine. The company that owned the machine had already been held liable for the injury.

The officers of the company, however, allegedly defrauded the company of its assets. The victim was now suing under RICO for loss of the property right that was the only thing she had left after the personal injury suit was gone and done with. This was not a personal injury suit. This was a suit to get the money that was legally hers under a judgment that had already been passed in court. The citing of this case is an example of the kind of misrepresentation of this supposed "abuse" that has characterized the assault on civil RICO.

Senator METZENBAUM. She already had the judgment?

Mr. HARD. Yes, she already had the judgment. In fact, I can—

Senator METZENBAUM. This was part of the collection procedure?

Mr. HARD. This was part of the collection procedure, and the plaintiff alleged a pattern of Federal income tax fraud and other crimes. Why do you suppose a member of the accounting industry was a defendant here?

Ms. CLAYBROOK. We would like to submit, Senator, if we could, the rest of the testimony. We did prepare sort of a supplementary testimony after we listened to the testimony by the accountants.

Senator METZENBAUM. We will be happy to have it.

Ms. CLAYBROOK. We understand the effort that you have made, Senator, to try and put together something that has our interests included as well as those of others. We think it goes too far. That is where we come out.

We think that this is a critically important statute. We think that some of the problems that existed that were complained about several years ago, the courts have remedied. Courts are dismissing now many cases where attorneys are attempting to use RICO where the courts feel that it is inappropriate.

We think that the courts in many ways have straightened out some of the original complaints that caused this legislation to begin 2½, 3 years ago, and I think that the federal docket reveals that when you see the number of cases that have been dismissed.

Senator METZENBAUM. Thank you very much. I appreciate it.

Ms. CLAYBROOK. Thank you.

Ms. GILBERT. Thank you.

Mr. HARD. Thank you.

Ms. CLAYBROOK. By the way, Senator, I would like to submit a statement, if I could, for Mr. Ralph Nader, some testimony that he gave in the House. He has not had an opportunity to testify here because he is out of town.

Senator METZENBAUM. We had looked forward to having him with us; I am sorry he was not.

Ms. CLAYBROOK. If I could submit that, we would appreciate it.

And we would say that we do agree among us that it would be very important to have further hearings, if you could, particularly focusing on some of the kinds of abuses that we see the statute is designed to remedy.

Thank you.

Senator METZENBAUM. Thanks very much.

[Statement follows:]

STATEMENT OF

JOAN CLAYBROOK, PRESIDENT,
PUBLIC CITIZEN

PAMELA GILBERT, STAFF ATTORNEY,
U.S. PUBLIC INTEREST RESEARCH GROUP

ERIC HARD, STAFF ATTORNEY,
PUBLIC CITIZEN'S CONGRESS WATCH

on

S. 1523, A BILL TO AMEND THE CIVIL
REMEDIES UNDER THE RACKETEER-INFLUENCED
AND CORRUPT ORGANIZATIONS ACT (RICO)

before the

SENATE JUDICIARY COMMITTEE

October 29, 1987

INTRODUCTION

Mr. Chairman, distinguished members of the Committee, Public Citizen* and the U.S. Public Interest Research Group** appreciate the opportunity to appear today to discuss S. 1523, a bill to reduce the civil remedies currently available to victims of organized criminal activity under the Racketeer-Influenced and Corrupt Organizations Act (RICO). Our organizations are dedicated to preserving and strengthening the remedies available to consumers and others who fall victim to fraud and other white-collar crime.

Mr. Chairman, we appreciate the efforts you have made to protect the rights of victims of sophisticated criminal activity to have meaningful access to the courts to seek redress against the wrongdoers. We understand that you have attempted to consider the interests of businesses that claim that civil RICO is being misused against them as well as the interest of the public in fighting the white collar crime that pervades our society. However, as we will testify, we do not believe that civil RICO lawsuits pose a significant problem to businesses and individuals that have not engaged in patterns of crime. The assertion that innocent defendants must settle to avoid treble-

*Public Citizen is a nonprofit research and advocacy organization founded by Ralph Nader in 1971 that works on behalf of its over 60 thousand members and all consumers. Congress Watch is the legislative advocacy arm of Public Citizen.

**U.S. Public Interest Research Group is the national lobbying office for state PIRGs around the country. PIRGs are nonprofit, nonpartisan consumer advocacy organizations.

damage liability is questionable since the settlement value of a meritless case can scarcely exceed the value of the final judgment--which, according to RICO's opponents, is zero.

RICO is an invaluable weapon in the counterattack against pervasive criminal fraud. We oppose enactment of this legislation because we do not believe a case for taking away this weapon has been made by the business proponents; nor can it be argued that consumer or business fraud is on the wane.

THE IMPORTANCE OF CIVIL RICO TO CONSUMERS

The Racketeer-Influenced and Corrupt Organizations Act provides enhanced penalties for pervasive or "patterns of" racketeering behavior conducted in relation to an enterprise. The outlawed behavior includes numerous state and federal crimes, such as murder, arson, bribery, prostitution, and mail, wire, securities and bankruptcy fraud. A "pattern" of criminal behavior is defined in the statute as "requiring at least two acts" of racketeering behavior committed within ten years of each other. Under RICO, it is unlawful to:

- a) use or invest the proceeds of racketeering activity in an enterprise;
- b) acquire or maintain an interest in an enterprise through a pattern of racketeering activity;
- c) conduct or participate in the affairs of an enterprise through a pattern of racketeering; or
- d) conspire to do any of the above.

Section 1964(c) of the statute provides victims of this systematic criminality with a federal cause of action for treble

damages, costs, and attorney's fees. It is these civil provisions that are currently under attack.

Civil RICO is the consumer's best remedy against white collar crime and other forms of sophisticated criminal behavior. First, by providing for recovery of attorney's fees, it enables victims who otherwise would not be able to hire an attorney to bring their cases to court. In addition, unscrupulous defendants can very easily increase the cost of litigation so that, without attorney's fees, the average person stands little chance.

Second, civil RICO provides for automatic treble damages. These damages serve a deterrent as well as compensatory function. Without treble damages, the possible punishment (if one is caught) for engaging in financial crime would be merely returning what was taken. Discounting the probability of being caught and the likelihood of being sued or found guilty, mere actual damages are not much of a deterrent. If persons considering embarking on a coldly-calculated financial racket know that they face automatic treble damages, there is more of a likelihood that they will refrain from criminal behavior. In addition, court-awarded damages do not compensate victims for the psychological and emotional distress they have suffered, nor do they provide for interest on the money stolen. Treble damages help compensate these losses as well.

Third, the existence of a federal forum provides necessary procedural benefits to victims of multi-state systematic criminal

behavior. Current law does not require that a state court allow the plaintiffs in an interstate scheme to sue out-of-state defendants in one state's court. Not only could this result deprive victims from being able to receive compensation for their losses, but it may enable the crimes to continue unabated in other states. Furthermore, litigation of these complex criminal schemes would be open to inconsistent rulings on the same facts and would be much less efficient without the ability to bring suit in federal court.

Victims of white-collar crime are often the elderly, poor, disabled and illiterate, among the most vulnerable members of society and the least able to protect their own interests. For example, nine plaintiffs sued Atlantic Permanent Federal Savings and Loan claiming that the Bank conspired with home-improvement dealers in a scheme to obtain second mortgages on lower and middle class homes without the knowledge of the homeowners. The defendants allegedly targeted elderly, poor and handicapped people, and it is estimated that 500 to 750 people were victimized by this fraud. The nine named plaintiffs lost their homes as a result of the scam.

Civil RICO enabled these impoverished victims to successfully sue the largest bank in Norfolk, Virginia for perpetrating this crime. It is interesting to note that, although civil RICO provides for automatic treble damages, the settlement agreement with the bank awarded less than actual damages to each victim. Clearly, treble-damage liability was

important to encourage settlement, but did not result in "windfall" gains for any of the parties. It did, however, give these downtrodden people the means with which to vindicate their rights.

In another case, 423 residents of a retirement community successfully sued the mortgagee for participating in a scheme to fraudulently induce them to purchase life-time occupancy agreements. Many of the plaintiffs invested their life savings to purchase what they believed would be a residence to take care of their needs for the remainder of their lives. After \$60 million had been paid into the village, these elderly, ill and disabled people discovered that the facility had always been financially unsound and faced possible collapse.

The victims of this scam used civil RICO to sue the perpetrators and save themselves from financial ruin. Under the terms of the settlement agreement, the entire mortgage indebtedness of the village was cancelled, and more than \$13 million was restored to the victims. In testimony before a subcommittee of the House of Representatives, the attorney in this case stated that "there is no question in my mind but that the results in our lawsuit would not have been attainable were it not for the RICO statute."

THE "FLOOD"

Proponents of weakening RICO have claimed it is necessary to stop a flood of meritless RICO suits that has resulted from the

ease with which such suits can be brought. This argument is belied, however, by data from the Administrative Office of the U.S. Courts showing that just 1,069 civil RICO cases were filed in 1986--less than one half of one percent of the total federal docket of 275,000 cases. As of December 31, 1986, just 894 civil RICO cases nationwide were pending.

A study of reported civil RICO cases for 1985 and 1986 shows that 50 percent of them did not survive a motion to dismiss. In fact, 40 percent of all these cases were dismissed on "pattern" grounds alone.

The prevailing interpretation of "pattern" among the federal courts requires a showing of more than one criminal act and actual ongoing criminal behavior or the threat that the behavior will continue. Where a plaintiff alleges merely multiple mailings connected to the same fraud, an abuse commonly cited by RICO's opponents, courts will dismiss the suit for failing to show a "pattern" of activity.

As the above figures suggest, there is hardly a "flood" of civil RICO cases; in addition, those cases that are filed must withstand an increasingly rigorous definition of "pattern" in order to survive. The simple fact is that, where there has not been continuing criminal activity, RICO suits do not succeed.

S. 1523 IS A FLAWED BILL

While this bill clarifies some important consumer protections in the RICO statute, it is nonetheless seriously flawed.

We endorse the provisions of S. 1523 that retain treble damages, costs and fees for federal, state and local governments in suits brought by them and for all plaintiffs in cases in which the defendant has been convicted. We are concerned, however, that private businesses would be confined to actual damages, and consumers, except in special circumstances, could sue only for actual damages as well. Under the bill, consumers would be denied treble damages and would at best receive a chance at punitive damages of up to twice their actual damages. In addition, where consumers may bring suit under securities laws (which require merely that defendants disgorge what they have stolen), they are precluded from pursuing any damages above actual damages unless they are classified as "small investors."

SECURITIES FRAUD

We share your concern that people with few resources, such as those who fall within the "small investor" category, need the potent tools of civil RICO in order to effectively press their claims against well-heeled criminals. We believe, however, that in an age of scarce prosecutorial resources and mounting securities fraud, any special treatment for criminals in the securities area is simply unwarranted.

According to Newsweek, 15,915 complaints about brokers were filed with the SEC in 1986, an increase of 128 percent in four years. In his book, Mugged on Wall Street (Simon & Schuster, 1987), David Chase, Vice President of E.F. Hutton, observes:

The [many millions] made [by Dennis B. Levine and Ivan Boesky] as insiders was indirectly siphoned from the investors who use Wall Street. That's why the SEC indicted them. But those dollars are nothing compared to the amount of money Wall Street loses for its investors through well-hidden fees, incompetence, and greed. That is the real scandal.

Under the bill, businesses and private investors who do not fall into the aptly-termed "small investor" category are arbitrarily stripped of their right to anything beyond actual damages, unless, in the case of natural persons, the violations concern insider trading. We believe that individual consumers, small and large investors alike, who have been harmed by a pattern of intentional securities fraud, should be entitled to treble damages.

A scam by a top New York Life Insurance agent in Portland, Oregon, is a case in point. The agent solicited several million dollars from investors and then lost or diverted their funds. Among his victims was an elderly couple whose life savings was invested and then lost. The reason for the investment was that the husband had Alzheimer's disease, and the couple needed a secure yield on their money. Another victim was a newly widowed mother with small children. She invested approximately \$137,000 from her husband's life insurance policy for care and education of herself and her children. All her money was lost.

Under the definition of "small investor" in S. 1523, in all likelihood, these victims would not be eligible to recover anything more than what was stolen from them. Because the settlement value in such cases would be significantly diminished under the bill, few attorneys would be willing to represent these victims against a company as large as New York Life.

ACTUAL DAMAGES

By far the largest group of civil RICO plaintiffs--businesses and institutions--would be precluded under S. 1523 from ever seeking more than actual damages in a RICO lawsuit. Since these plaintiffs are best equipped to bring RICO suits--and advance the deterrent effect envisioned in the statute--we believe they should not be discouraged from doing so.

For example, mutual funds, welfare funds, universities, churches, and other not-for-profit institutions would be unable to seek treble damages when they have been victimized by fraud. Undoubtedly, the welfare of the individuals who depend on these institutions is threatened when the institutions are financially decimated through criminal fraud schemes. Since the institutions themselves are best equipped to represent the parties' collective interests in court, the loss of treble damages would be a serious blow to the victims and to the statute's value as a deterrent.

In addition, many small businesses that have been victimized by powerful corporate criminals would be unable to seek multiple damages under the bill. One small firm in Washington state was

put out of business by the illegal dumping of toxic wastes next to the firm's place of business. Through the use of civil RICO, the firm secured a multi-million-dollar settlement from Boeing, the principle source of the waste.

With respect to this last case, it should be noted that hazardous-waste litigation is extremely expensive in terms of lawyers and consultant fees. A company that has lost everything can hardly justify initiating such costly litigation. According to Steve Hale, the attorney who brought the Boeing suit and requested to testify at this hearing, only through the remedies provided in civil RICO could such a case have been filed.

RETROACTIVITY

The bill's retroactivity provision would provide a windfall for current RICO defendants, whose liability--no matter how clearly established--would be abruptly reduced. This provision is utterly unfair to plaintiffs who have invested considerable time and resources pursuing their claims. Retroactivity would pose particular hardships for civil RICO plaintiffs, because the complex nature of RICO often means that the lawsuits will take several years and many thousands of dollars before they even go to trial. In effect, the rules would be changed in the middle of a very long and expensive game.

This provision is particularly insidious because individual companies with pending cases lobbying for the bill could reap large benefits unbeknownst to Senators who vote for it. Thus, we

strongly believe that in the interest of openness, any pending suit benefitting from this windfall should be listed in the statute.

COMMODITIES FRAUD

It has come to our attention that an amendment may be offered to S. 1523 providing an exemption from civil RICO for the commodities industry similar to that currently provided by the bill for the securities industry. In an age of widespread commodities fraud, such a provision would be counterproductive. In April of last year, the American Association of Retired Persons reported:

Investors in the International Gold Bullion Exchange recently lost over \$40 million and investors in Bullion Reserve of North America lost \$60 million because the precious metals they were purportedly buying did not exist. Over 50,000 investors in various foreign currency scams run by just one operator may have seen the last of their money--over \$100 million.

According to the AARP, these and other commodity frauds swindle investors out of over \$1 billion a year.

UNANSWERED QUESTIONS

Crucial information should be presented before this sweeping legislation is enacted. For example:

* Much has been made of the alleged problem of frivolous RICO suits. Has anyone analyzed the RICO docket to determine the number of such suits?

* What evidence is there that any one special interest group, be they accountants, bankers, insurers, securities dealers or commodities brokers, should be specially exempted from RICO's treble-damage liability?

* Should this Congress pass legislation that would apply retroactively to lawsuits that were brought in good faith reliance on the provisions of a previous act of Congress without knowing the circumstances of those cases and the cost to the plaintiffs?

* Business proponents allege that RICO has forced innocent defendants to settle undeserving cases, but where is the empirical data to substantiate this claim?

CONCLUSION

In recent years we have witnessed an unprecedented wave of corporate fraud and white-collar crime. Congressional hearings have documented and exposed this flood of crime with reports of massive securities fraud costing businesses and individuals upwards of \$8 billion a year, check-kiting schemes by major investment brokers, and the loss of billions of dollars of Savings and Loan assets attributable to criminal and fraudulent activities. When we are in the middle of a white-collar crime epidemic and there remain so many unanswered questions, is this the time to disarm the consumer's best weapon - RICO?

We think not. Thank you.

SUPPLEMENT TO STATEMENT OF

JOAN CLAYBROOK, PRESIDENT,
PUBLIC CITIZEN

PAMELA GILBERT, STAFF ATTORNEY,
U.S. PUBLIC INTEREST RESEARCH GROUP

ERIC HARD, STAFF ATTORNEY,
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on

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before the

SENATE JUDICIARY COMMITTEE

November 10, 1987

Commentary on evidence of so-called RICO abuse presented to the Senate Judiciary Committee on October 29, 1987 by the American Institute of Certified Public Accountants

In what was perhaps the most concrete testimony provided by opponents of civil RICO at the hearing held before this committee on October 29, 1987, the American Institute of Certified Public Accountants cited a handful of cases in support of its contention that "the level of misuse" of civil RICO "in fact continues."

The AICPA listed eight cases under seven categories which, according to the accountants, are areas in which merely to bring a RICO claim is to engage in "misuse." For example, the accountants list a "landlord-tenant dispute," Bros v. Culvers, 650 F. Supp. 874 (D.D.C. 1987). While the plaintiff was undisputedly a tenant and the defendant a landlord, the plaintiff alleged separate violations of mail fraud and wire fraud. Although the court acknowledged that these allegations might prove true, it nonetheless dismissed the case on "pattern" grounds. Thus, to the extent that this case could be viewed as inappropriate, the tools were available to the court to deal with it--i.e., it was dismissed.

A second case cited by the accountants involved "sexual harassment," Hunt v. Weatherbee, 626 F. Supp. 1097 (D. Mass. 1986). This case was a suit against a labor union including allegations of physical assault, intimidation, loss of employment, and extortion. While sexual harassment of the plaintiff was unquestionably involved, the alleged acts committed in furtherance of this goal were precisely the sort of organized criminal conduct against an innocent person that civil RICO was designed to redress. The court agreed, and held that the

plaintiff had stated a valid cause of action under civil RICO for an alleged pattern and practice of sexual discrimination and sexual harassment. The court noted:

It is certainly a reasonable inference from the alleged facts that [the defendants] acted against Hunt in order to quell any dissention or conflict within the work setting, even at the expense of ignoring a serious assault against one of Local 40's own members. Worse, this particular action against [the plaintiff] may have simply represented one instance in a longstanding effort by union officials to maintain the status quo by harassing and discriminating against female union members.

We believe that a pattern of organized violence and extortion to promote sexual discrimination, if proved, is a worthy subject of redress under civil RICO. The attempt to belittle the plight of victims of such discrimination is only further evidence of how far we have yet to go in combatting such abuse in our society.

A third case cited by the accountants involved "disputes between employers and employees over discharges," Acampora v. Boise Cascade Corp., 635 F. Supp. 66 (D.N.J. 1986). In this case, the plaintiff was an employee who discovered that her manager was stealing goods from the company and had set up an operation to distribute this contraband. The manager then allegedly harassed the plaintiff and caused her to lose her job. This was clearly no ordinary employer-employee dispute. While the court found the plaintiff's complaint technically incomplete, it ruled that it was susceptible to amendment, and stated: "We find that the plaintiff's complaint sufficiently alleges that [the] defendant...utilized his position within the enterprise to engage in racketeering activity, and thus states a claim under

RICO."

Another case cited by the accountants involved "personal injury," Wooten v. Loshbough, 649 F. Supp. 531 (N.D. Ind. 1986). This case is of particular interest, since one of the named defendants was the accounting firm of McGladney, Hendrickson and Pullen. The question comes to mind: Why was an accounting firm a defendant in a "personal injury" case?

In this case, the plaintiff lost fingers in a defective press machine and recovered an \$850,000 judgment. The defendant company, however, lacked the means to pay the judgment, because the plaintiffs allegedly stripped the company of its funds. In her RICO claim, the plaintiff alleged a pattern of illegal conduct including misuse of company funds and falsification of tax returns, resulting in the failure of the company to buy product liability insurance.

While the defendants certainly argued that this was solely a "personal injury" case, the court noted that "the injury of which [the plaintiff] complains is to her ability to enforce her judgment, not to her person." The court continued:

Ms. Wooten's judgment extinguished her personal injury claim; it provided her with a right that was assignable and devisable. The defendants' continuing racketeering activity, however, reduced the value of that right. These allegations state a claim under RICO's civil provisions.

We submit that it is precisely the sort of fraud and abuse of the property of individuals like Ms. Wooten that civil RICO was designed to remedy. In the above case, Ms. Wooten was mutilated in an accident that never should have happened, then deprived of the compensation that was legally hers through a

pattern of criminal activity.

One of the common objections to the use of civil RICO in securities-related cases is that RICO "evade[s] the standards" of "carefully-crafted" laws. One of the cases cited by the accountants to support this claim was Youmans v. Simon, 791 F. 2d 341 (5th Cir. 1986). In this case, the plaintiff alleged material omissions and misrepresentations in an investment scheme involving an apartment complex. The court held that the transactions at issue were not "securities," and thus, that the securities claims were inapplicable. The court found, however, that a pattern of criminal activity under RICO had been sufficiently alleged, and permitted this claim to proceed. The question thus arises: If this was not a securities case, under what possible logic is it an "evasion of the standards" of the "securities laws" to allow the well-pleaded RICO claim to proceed?

In conclusion, we do not believe that the above-cited cases are examples of "abuse" of the civil provisions of RICO. They are, however, indicative of the types of criminal behavior that often go unpunished and for which the victims rarely receive redress. If examples such as these are the best that RICO's opponents can muster, then we believe they have not met their burden in showing why this important anti-crime statute should be so drastically weakened. We urge the committee to conduct a further analysis of the charges of RICO "misuse" along with an examination of RICO's usefulness before enacting legislation, such as S. 1523, that would curtail the remedies available to victims of organized criminal activity.

Senator METZENBAUM. Mr. Engman, we are happy to have you with us. I hope your throat is also better. Mine is somewhat better.

STATEMENT OF LEWIS A. ENGMAN, COUNSEL, WINSTON AND STRAWN, ON BEHALF OF STALEY CONTINENTAL, INC., WASHINGTON, DC

Mr. ENGMAN. Much better, Mr. Chairman.

Senator METZENBAUM. I want to say that I have some concerns about your testifying about a client involved in litigation. Normally, I do not think that is good policy. However, two other Senators asked that you be allowed to testify.

I would therefore ask that you confine your testimony to general policy issues rather than the particular facts of the pending litigation, and the Chair is not willing to include in the record any discussion of the litigation itself, but willing to have your advice with respect to the legislation.

Mr. ENGMAN. Well, Mr. Chairman, let me say first of all that I do thank you for the opportunity to appear today. It is always a pleasure for me, a particular pleasure, to testify before this committee.

I must say I do think that it is somewhat unfair that this position is taken. I understand the propriety of it in general terms, but the fact of the matter is that the defendants in these pending cases, the Drexel Burnhams and the security brokers' firms, are already represented in the testimony before this committee through their trade associations.

There are no plaintiffs' trade associations, and I think it is not particularly appropriate that defendant investment banking companies can be protected by trade association testimony, but not other witnesses.

Senator METZENBAUM. I do not intend to protect them, but I do think, Mr. Engman, that it is not a policy of our hearing process to hear about cases that are in the process of litigation.

I believe this is a hearing having to do with a pending piece of legislation. I had some questions about your being on the panel originally as a witness. Two Senators asked that you be heard. I am willing to have you be heard, but I think that the only thing that seems to me to be relevant to this hearing is your views with respect to the legislation, not your views with respect to the litigation.

Mr. ENGMAN. Mr. Chairman, let me see what I can do to accommodate you and, I think, the interests of the public at the same time.

Senator METZENBAUM. OK.

Mr. ENGMAN. The reform proposal, we believe, is retroactive in that it would limit the recovery in pending suits to actual damages in cases involving two commercial parties. The sole exception to this retroactive limitation upon treble damage awards is when, in light of all the circumstances, the limit would be clearly unjust. The vagueness of the "clearly unjust" standard is so pervasive that the exception has little, if any, utility.

Now, we do appreciate the policy concerns prompting RICO reform. At the same time, we are concerned that laws which are

limited to single damages are inadequate to police and prosecute massive stock manipulation and conduct amounting to extortion.

Furthermore, we believe equally strongly that just because RICO may have been abused by some plaintiffs, the Congress should not arbitrarily step into courtrooms throughout the country and disrupt pending lawsuits involving RICO counts, because that is what this proposal does.

In fact, whether or not you want to involve the Judiciary Committee in pending lawsuits, the retroactive provisions do, in fact, involve the committee in pending lawsuits because the reform bill would change the rules in midstream.

I would like to suggest that the reform spirit of your RICO reform bill, Mr. Chairman, would be better served if the retroactivity provisions were deleted. Retroactivity provisions are inconsistent with the principles of sound legislation.

Retroactive laws that ease sanctions after the fact encourage public cynicism towards the laws and the judicial process. This is especially true when the sanctions being eased are perceived to apply primarily to white-collar crime cases.

In fact, retroactive laws are unfair. Treble damage awards in civil RICO cases were permitted because Congress recognized that the potential for substantial awards was necessary to encourage private citizens to go through the expense, the aggravation, and the disruption that a lengthy and complex lawsuit occasions.

If Congress changes the rules with respect to these pending cases, it will have committed a manifest injustice. It sends the wrong signal to the public. It demonstrates that wrongdoers can go unpunished, or at least have their punishment reduced by appealing to the Congress. That is what these defendants are doing. We only ask for the same right to appeal.

Moreover, retroactive changes to the law provide a windfall to those defendants who are found guilty but will not be required to pay the damages for which they were liable at the time they broke the law. In effect, you are winking at wrongdoing.

Now, obviously, as you indicate, our interest in the issue of retroactivity is more than academic.

Senator METZENBAUM. More than what?

Mr. ENGMAN. More than academic. In February of this year, our client, Staley Continental, filed suit against Drexel Burnham Lambert under RICO alleging, in particular, that the firm was guilty of extortionate conduct toward Staley in the fall of 1986.

Senator METZENBAUM. Mr. Engman, I am going to have to cut you off there. I think your testimony with respect to the retroactive aspects of the legislation is very pungent and very effective, but when you get into the—

Mr. ENGMAN. Now, I am not here to discuss the details of the lawsuit, but I want to emphasize that this lawsuit and others like it clearly are not garden variety types of commercial litigation, or even typical, garden variety securities fraud lawsuits.

They are appropriately brought under the RICO statute, which seeks to provide substantial penalties for extortionate conduct whether or not the defendant is a so-called respectable or legitimate business enterprise.

Applying RICO reform retroactively is in no sense a neutral act. The impact falls squarely on plaintiffs who have brought cases in reliance upon the laws as they exist. These lawsuits and ours are a powerful example of how the retroactive application of the reform effort, no matter how worthy or important, can unfairly reward one party to a lawsuit—the party who is adjudged guilty and then absolved of a large portion of the liability it knowingly incurred when it engaged in this illegal conduct.

Large and sophisticated companies like some of these major firms do have access to expert legal and professional advice. They do not deserve special exemption from existing law with respect to pending actions.

These firms are not uninformed or unwitting of RICO. If the allegations of the kind of lawsuit I hypothetically suggested are proven, the investment banking defendant deserves no special treatment and should be subject to the full extent of the law's penalties.

In general, defendants in these RICO actions around the country have to take comfort in the retroactivity provisions of this reform bill. It holds out the promise of substantial rewards for utilizing every single delay tactic in the lawyer's arsenal. The perversity of the retroactive provision is that it encourages conduct which is antithetical to judicial reform.

In conclusion, let me just say that we believe that the retroactivity provisions of S. 1523 are not reform and they are not good public policy. Retroactivity rewards wrongdoers. Retroactivity encourages disrespect for the law. Retroactivity plays favorites between and among litigants.

Surely, these objectives do not deserve the title of reform. We urge you to reconsider your bill and to eliminate the retroactivity provisions in it.

Thank you very much, Mr. Chairman.

Senator METZENBAUM. Thank you.

Mr. ENGMAN. I would be happy to answer any questions. As you know, I have a more complete statement which I submitted. I would like to urge you to include it all in the record.

Senator METZENBAUM. We will examine your statement, Mr. Engman, and probably include almost all of it. If we think there are some portions of it that we feel appropriate to purge, we will do that, but I am sure it would be very little of it that we would do. Certainly, the thrust of your comments is well understood and certainly presented effectively, and we appreciate it.

Thank you very much.

Mr. ENGMAN. Let me just say, Mr. Chairman, with respect to these kinds of lawsuits we are not talking about normal securities lawsuits here. I refer you to the March 9 Business Week which had an article about the particular lawsuit that I am concerned about, and I will not quote from it with respect to specifics.

But the article states that, "Corporations have long complained privately about 'blank's' hardball tactics in securing new clients and retaining old ones. Fearful of retaliation by 'blank,' however, they have almost never been willing to go public with their concerns."

These people act as a fraternity on Wall Street. We are seeing some of the problems that have resulted from alleged stock manipulation and all sorts of things in current weeks. As the business press itself realizes, normal statutes have not been sufficient in the past to encourage legitimate corporate plaintiffs to challenge some of these alleged wrongdoings.

Senator METZENBAUM. Am I correct in my understanding that you would have no objection to the bill if the retroactive provisions were deleted?

Mr. ENGMAN. Without saying that I would agree with every single dotted "i" and crossed "t," in general we understand that there is some reason for RICO reform, but I very violently oppose retroactivity.

I think you know, Senator, I have testified before this committee for some 15 years. On not one occasion have I ever testified in favor of retroactive provisions. I know that you have been opposed to it in the contribution legislation which was here before us five years ago.

I have an interesting observation, I think, just in concluding. This committee has been involved in retroactive fights on many different pieces of legislation since I started testifying before you in 1973.

The interesting thing about it is in almost all of those instances, including retroactive provisions meant that no legislation ultimately got through. You can ask the minority and the majority members in terms of the contribution brouhaha that went on last year.

What happens, I am afraid, from my observation on the outside is that some narrow special interests get so greedy when they get close to a particular change that they are seeking that these special interests try to take too many cookies out of the jar at one time and the whole thing goes down.

I would urge you to consider, if we really want to get some sort of reform in RICO, that retroactivity be eliminated as a part of RICO reform.

Thank you very much.

Senator METZENBAUM. Thank you very much. Your point with respect to my position in connection with the contribution bill and being opposed to retroactivity, I think, is a salient point, a significant one, and the Chair intends to take it into consideration.

Mr. ENGMAN. I have a wonderful, long quotation from the joint statement which you and Senator Kennedy gave at that time, Senator, and I might say that I still endorse every single word of it. I agree with you that retroactivity was wrong in the contributions bill and I hope you would agree with me, on reflection, that retroactivity is wrong in the RICO reform bill.

Senator METZENBAUM. There is much to take into account with respect to your statement. Thank you very much.

Mr. ENGMAN. Thank you very much.

Senator METZENBAUM. The committee stands adjourned.

[Whereupon, at 3:34 p.m., the committee was adjourned.]

[Prepared statement of Lewis A. Engman follows:]

STATEMENT OF
LEWIS A. ENGMAN
ON BEHALF OF
STALEY CONTINENTAL, INC.
DURING HEARINGS ON S. 1523
BEFORE THE
COMMITTEE OF THE JUDICIARY
UNITED STATES SENATE

Tuesday, November 10, 1987

Mr. Chairman and Members of the Committee, thank you for providing the opportunity to appear today. My name is Lewis Engman and I am appearing here as counsel on behalf of Staley Continental, Inc., a diversified food company located in Illinois, Tennessee, California and elsewhere, whose stock is publicly traded on the New York Stock Exchange.

Today's hearing is focused upon S. 1523, a bill introduced by Senator Howard Metzenbaum to reform the Racketeer Influenced and Corrupt Organizations (or RICO) Act. RICO was enacted in 1970 to deter certain illegal activities. The treble damages provision was included in civil RICO actions to supplement scarce prosecutorial resources by giving victims of these illegal activities the financial incentive to bring lawsuits. In recent years, proponents of RICO reform have argued that RICO induces too much litigation, and that much of it is of little consequence, at best. The reform proposal is intended to limit the potential for treble damage awards in a civil RICO suit to cases in which the plaintiff is a governmental body, or where the defendants previously have been convicted of a RICO violation or of an underlying criminal act.

The reform proposal also would limit the recovery in pending suits to actual damages in cases involving two commercial parties. The sole exception to this retroactive limitation upon treble damage awards is when "in light of all the circumstances" the limit "would be clearly unjust." The vagueness of the clearly unjust standard is so pervasive that the exception has little, if any, utility.

We are prepared to accept many of the arguments of RICO reform proponents. We believe the increasing number of RICO suits, the application of RICO to simple commercial disputes, the potential for frivolous lawsuits, and the application of the label of racketeer are all legitimate policy concerns that should be addressed by the Congress.

At the same time, however, we are concerned that laws which are limited to single damages are inadequate to police and prosecute massive stock manipulation and conduct amounting to extortion. Changing the treble damages provision for RICO violations in these cases will discourage the private litigation that seeks to curb illegal behavior in the securities markets.

Furthermore, we believe equally strongly that just because RICO may have been abused by some plaintiffs, the Congress should not arbitrarily step into courtrooms throughout the country and disrupt pending lawsuits involving RICO counts. Unfortunately, this is precisely what the RICO reform legislation would accomplish. It would change the rules in pending cases.

The reform spirit of the RICO reform bills would be better served if the retroactivity provisions were deleted. Retroactive provisions are inconsistent with the principles of sound legislation. Retroactive laws frustrate the law's central purpose of guiding behavior by disrupting expectations and actions taken in reliance of the law. Retroactive laws that ease sanctions after the fact encourage public cynicism. This is especially true when the sanctions being eased are perceived to apply primarily to white collar crime cases. Retroactive laws are unfair.

Retroactive application of changes to RICO is an obvious injustice to plaintiffs with pending cases. Treble damage awards in civil RICO cases were permitted because Congress recognized that the potential for substantial awards was necessary to encourage private citizens to go through the expense, aggravation and disruption that a lengthy and complex lawsuit occasions.

As this hearing gets underway, plaintiffs in courtrooms throughout the country have filed cases and endured the expense, aggravation and disruption in part because of the potential of receiving a treble damage award. If Congress changes the rules with respect to these pending cases, it will have committed a manifest injustice. In addition, changing RICO retroactively sends the wrong signal to the public. It demonstrates that wrongdoers can go unpunished -- or at least reduce their punishment -- by appealing to the Congress. Moreover, retroactive changes to the law provide a windfall to those defendants who are found guilty, but will not be required to pay the damages for which they were liable at the time they broke the law. In effect, wrongdoing is winked at.

Obviously, our interest in the issue of retroactivity is more than academic. In February, 1987, Staley filed suit against Drexel Burnham Lambert, Inc. under RICO, the Securities Exchange Act and the common law, alleging in particular that Drexel Burnham was guilty of extortionate conduct toward Staley in the fall of 1986. The Complaint alleges that Drexel Burnham and persons associated with it established substantial positions in Staley's common stock, contacted Staley and sought to establish an

investment banking relationship. When the attempt failed, Drexel Burnham tried to coerce Staley management to postpone a proposed offering of its common stock, and to cooperate with Drexel Burnham in a leveraged buyout of the company.

I am not here to discuss the details of the Staley lawsuit, but I do wish to emphasize that the Staley lawsuit clearly is not a "garden variety" type of commercial litigation or even securities fraud lawsuit. It is appropriately brought under the RICO statute, which seeks to provide substantial penalties for extortionate conduct, whether or not the defendant is a so-called respectable or legitimate business enterprise.

The retroactive application of the proposed RICO reform is in no sense a neutral act. The impact falls squarely on plaintiffs who have brought cases in reliance upon the laws as they exist. The Staley lawsuit is a powerful example of how the retroactive application of the reform effort, no matter how worthy or important, can unfairly reward one party to a lawsuit -- the party who is adjudged guilty and then absolved of a large portion of the liability it knowingly incurred when it engaged in the illegal conduct. Large and sophisticated companies like Drexel Burnham that have access to expert legal and professional advice do not deserve special exemption from existing law with respect to pending actions. Such firms are not uninformed or unwitting of RICO. If the allegations of the Staley lawsuit are proven, Drexel Burnham deserves no special treatment and should be subject to the full extent of the law's penalties.

In general, defendants in RICO actions around the country must take comfort in the retroactive provisions of this reform bill. It holds out the promise of substantial rewards for utilizing every delay tactic in the lawyers' arsenal. The perversity of the retroactive provision is that it encourages conduct which is antithetical to judicial reform.

In conclusion, we believe the retroactivity provisions of S. 1523 are not reform and are not good public policy. Retroactivity rewards wrongdoers, encourages disrespect for the law and plays favorites between and among litigants. Surely, these objectives do not deserve the title of reform. We urge you to reject the retroactivity provisions in the RICO reform bill.

APPENDIX

WRITTEN STATEMENT OF THE
FUTURES INDUSTRY ASSOCIATION
BEFORE THE
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
OCTOBER 29, 1987

The Futures Industry Association (FIA) appreciates this opportunity to share its views with the Committee on the Judiciary on the critical issues concerning reform of the Racketeer Influenced and Corrupt Organizations Act (RICO).

FIA is the national, voluntary membership trade association of the commodity futures and options trading industry. FIA's regular membership includes over 100 of the largest registered brokerage firms engaged in futures trading, called "futures commission merchants" or "FCMs." Among our 150 Associate members are all U.S. futures exchanges and many banks, law and accounting firms, and market users. Also represented in our membership are a number of foreign brokerage firms and exchanges. It is estimated that over 80% of the public customer business done on U.S. futures exchanges is transacted through FIA members.

FIA applauds the leadership and foresight of this Committee in its efforts to reform RICO. In the civil context, RICO has been stretched to the limit, and certainly beyond its intended scope, to ensnare legitimate businesses. The threat of treble damage awards

has been used as a lever to secure settlements without regard to the merits of a particular case. It has been the experience of the futures industry that private plaintiffs routinely allege both a Commodity Exchange Act violation and a RICO violation, using mail or wire fraud as the alleged predicate offense since neither violating of the CEA nor commodity fraud are predicate offenses under RICO. The Office of the General Counsel at the Commodity Futures Trading Commission reviewed a representative sample of the reported court cases in which private civil RICO claims have been made in commodities cases. It found that the allegations often involve the same course of conduct and seek double recovery for the same injury. Further, while many RICO claims are eventually dismissed, the costs of defending are not insignificant. (Letter to Senator Metzenbaum from Marshall Hanbury, September 9, 1987, is attached hereto.)

S.1523 includes a provision that, except for certain specified categories of claims, restricts the availability of treble damage awards to cases where "neither State nor Federal securities laws make available an express or implied remedy for the type of behavior on which the claim of the plaintiff is based." This exemption represents sound public policy by recognizing legislatively created private rights of action specifically crafted to deter and redress securities law violations. We strongly urge that this provision be extended to include claims where State or Federal commodities laws provide an express or implied remedy.

In 1982, the Commodity Exchange Act (CEA), which provides for the

comprehensive regulation of the commodity futures and options industry, was amended to include specific private rights of action for damages in Section 22. The provisions of Section 22 were carefully crafted and adopted shortly after the Supreme Court upheld lower courts' rulings that implied private rights of action for damages existed for violations of anti-fraud and other provision of the CEA. While holding that a private right of action existed, the Court indicated that the elements of liability, causation, and damages were in doubt and remain to be determined. Merrill Lynch v. Curran, 456 U.S. 353(1982).

As a result of this "invitation" from the courts, the Congress provided a very broad private right of action for aggrieved individuals against all firms and registered employees or agents engaged in the commodity futures and options business for violations of the CEA. Similar remedies may also be sought against exchanges, clearinghouses and other self-regulatory organizations for damages resulting from their failure to enforce their rules. It is clear that Congress carefully and precisely crafted an explicit private right of action as the best mechanism for redress of commodity customer complaints. A substantial body of laws is being developed as a result. However, the intention of Congress in this regard is being undermined by a completely separate body of law being developed under RICO using mail and wire fraud as predicate offenses.

Commodities customers also have a statutory right to seek arbitration of their claims through a variety of self-regulatory organizations (SROs). Exchanges and the National Futures Association, the industry-wide self-regulatory authority, are required to provide an arbitration forum, and CFTC rules require SRO members to submit to arbitration if a customer seeks such relief. Finally, the CFTC itself provides a unique forum for the redress of customer grievances through its reparations program. A customer alleging violations of the CEA may file a complaint with the CFTC which will be adjudicated by an administrative law judge. Thus, while in many securities law cases investors must rely on court-constructed implied private rights of action, the federal commodities law specifically provides damage remedies. (A copy of Section 22 is attached hereto.)

Clearly, the commodities law is unique in the variety and breadth of remedies it provides for investors. It would be fully consistent with sound public policy to include commodities law claims in the proposed securities exemption. The proliferation of RICO claims despite the existence of several specially created statutory remedies, undermines the effectiveness and usefulness of these remedies specifically created for the protection of users of the commodities markets. The FIA strongly urges you to exclude from the treble damages provision of RICO unlawful activity for which remedies are already provided under state and federal commodities law.



OFFICE OF
THE GENERAL COUNSEL

COMMODITY FUTURES TRADING COMMISSION
2033 K STREET, N.W., WASHINGTON, D.C. 20581

September 9, 1987

Honorable Howard M. Metzenbaum
140 Russell Office Building
United States Senate
Washington, D.C. 20510

Dear Senator Metzenbaum:

The Commodity Futures Trading Commission ("Commission") is the independent federal regulatory agency responsible for the administration and enforcement of the Commodity Exchange Act, 7 U.S.C. § 1 et seq. Congress created the Commission in 1974 and renewed its mandate in 1978, 1982, and 1986. Through its regulatory and oversight programs, the Commission ensures the economic utility and integrity of futures markets by encouraging their competitiveness and efficiency and by protecting market participants against fraud and other abusive trade practices.

The Commission understands that you are sponsoring a bill to amend the private civil remedies provision of the Racketeer Influenced and Corrupt Organizations ("RICO") statute. See S. 1523. I urge you to consider modifying the proposed legislation so as to delete the triple damages provision of civil RICO if state or federal commodities laws provides an express or implied remedy for unlawful activity covered by those laws.

Since its enactment in 1982, Section 22 of the Commodity Exchange Act has provided a very broad express private right of action for the recovery of actual damages by customers from any person or entity who violates the Act. In addition, Section 22 of the Act provides an explicit right of action against exchanges, clearing organizations, and self-regulatory organizations for bad-faith failure to enforce their own rules or regulations or for violation of the Act or Commission regulations. Prior to the enactment of this express private right of action, the courts had widely recognized an implied private right of action. See Merrill Lynch Pierce Fenner & Smith v. Curran, 456 U.S. 353 (1982).

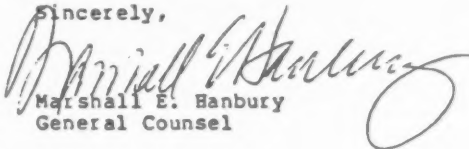
This Office has reviewed a representative sample of the reported court cases in which private civil RICO claims have been used in a commodities industry setting. We find that private plaintiffs typically allege both a Commodity Exchange Act violation and a RICO violation in their pleadings. These allegations often involve the same course of conduct and seek double recovery

- 2 -

for the same injury. Although many such civil RICO claims are eventually being dismissed as baseless by the courts, we find that commodities industry defendants are spending time and money resisting civil RICO claims for conduct within the scope of the Commodity Exchange Act, for which Congress has provided an express remedy. There has never been an explicit Congressional determination whether this represents sound public policy. In our judgment, it does not. Finally, there is no reliable way to measure the adverse impact that civil RICO "strike suits" may be having on the commodities industry-i.e.-cases brought for their nuisance value, or in the hope of obtaining a windfall settlement. For all these reasons, this Office endorses the efforts of the Futures Industry Association to obtain relief for the commodities industry from the private civil RICO triple damages provision.

I trust that you will find these comments helpful in your evaluation of the pending legislation to reform the private civil remedy provisions of RICO. Please ask your staff to call me (254-8058) if I can provide additional information.

Sincerely,



Marshall E. Hanbury
General Counsel

copy to: Honorable Patrick Leahy
United States Senate
Washington, D.C.

Honorable Kika de la Garza
United States House of Representatives
Washington, D.C.

Honorable John R. Bolton
Assistant Attorney General
Legislative and Intergovernmental Affairs
U.S. Department of Justice
Washington, D.C.

[§ 1476]

[PRIVATE RIGHT OF ACTION]

Sec. 22. (a)(1) Any person (other than a contract market, clearing organization of a contract market, licensed board of trade, or registered futures association) who violates this Act or who willfully aids, abets, counsels, induces, or procures the commission of a violation of this Act shall be liable for actual damages resulting from one or more of the transactions referred to in clauses (A) through (D) of this paragraph and caused by such violation to any other person—

(A) who received trading advice from such person for a fee;

(B) who made through such person any contract of sale of any commodity for future delivery (or option on such contract or any commodity); or who deposited with or paid to such person money, securities, or property (or incurred debt in lieu thereof) in connection with any order to make such contract;

(C) who purchased from or sold to such person or placed through such person an order for the purchase or sale of—

(i) an option subject to section 4c of this Act (other than an option purchased or sold on a contract market or other board of trade);

(ii) a contract subject to section 19 of this Act; or

(iii) an interest or participation in a commodity pool; or

(D) who purchased or sold a contract referred to in clause (B) hereof if the violation constitutes a manipulation of the price of any such contract or the price of the commodity underlying such contract.

(2) Except as provided in subsection (b), the rights of action authorized by this subsection and by sections 5a(11), 14, and 17b(10) of this Act shall be the exclusive remedies under this Act available to any person who sustains loss as a result of any alleged violation of this Act. Nothing in this subsection shall limit or abridge the rights of the parties to agree in advance of a dispute upon any forum for resolving claims under this section, including arbitration.

[Contract Markets and Clearing Organizations]

(b)(1)(A) A contract market or clearing organization of a contract market that fails to enforce any bylaw, rule, regulation, or resolution that is required to enforce by section 5a(8) and section 5a(9) of this Act, (B) a licensed board of trade that fails to enforce any bylaw, rule, regulation, or resolution that it is required to enforce by the Commission, or (C) any contract market, clearing organization of a contract market, or licensed board of trade that in enforcing any such bylaw, rule, regulation, or resolution violates this Act or any Commission rule, regulation, or order, shall be liable for actual damages sustained by a person who engaged in any transaction on or subject to the rules of such contract market or licensed board of trade to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaws, rules, regulations, or resolutions.

(2) A registered futures association that fails to enforce any bylaw or rule that is required under section 17 of this Act or in enforcing any such bylaw or rule violates this Act or any Commission rule, regulation, or order shall be liable for actual damages sustained by a person that engaged in any transaction specified in subsection (a) of this section to the extent of such person's actual losses that resulted from such transaction and were caused by such failure to enforce or enforcement of such bylaw or rule.

(3) Any individual who, in the capacity as an officer, director, governor, committee member, or employee of a contract market, clearing organization, licensed board of trade, or a registered futures association willfully aids, abets, counsels, induces, or procures any failure by any such entity to enforce (or any violation of the Act in enforcing) any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection, shall be liable for actual damages sustained by a person who engaged in any transaction specified in subsection (a) of this section (a) of this section on, or subject to the rules of, such contract market, licensed board of trade or, in the case of an officer, director, governor, committee member, or employee of a registered futures association, any transaction specified in subsection (a) of this section, in either case to the extent of such person's actual losses that resulted from such transaction and were caused by such failure or violation.

(4) A person seeking to enforce liability under this section must establish that the contract market, licensed board of trade, clearing organization, registered futures association, officer, director, governor, committee member, or employee acted in bad faith in failing to take action or in taking such action as was taken, and that such failure or action caused the loss.

(5) The rights of action authorized by this subsection shall be the exclusive remedy under this Act available to any person who sustains a loss as a result of (A) the alleged failure by a contract market, licensed board of trade, clearing organization, or registered futures association or by any officer, director, governor, committee member, or employee to enforce any bylaw, rule, regulation, or resolution referred to in paragraph (1) or (2) of this subsection or (B) the taking of action in enforcing any bylaw, rule, regulation, or resolution referred to in this subsection that is alleged to have violated this Act, or any Commission rule, regulation, or order.

[Jurisdiction of Courts]

(c) The United States district courts shall have exclusive jurisdiction of actions brought under this section. Any such action must be brought within two years after the date the cause of action accrued.

[Effective Date]

(d) The provisions of this section shall become effective with respect to causes of action accruing on or after the date of enactment of the Futures Trading Act of 1982: Provided, That the enactment of the Futures Trading Act of 1982 shall not affect any right of any parties which may exist with respect to causes of action accruing prior to such date. [As added by Act of January 11, 1973 (Futures Trading Act of 1982), effective January 11, 1983, Sec. 235, 96 Stat. 2294, 2322—2324.]

.01 1983 amendment.—For historical comment on amendments made by the Futures Trading Act of 1982, see § 11,680.001, 11,682.001, 11,684.001 and 11,686.001.

[§ 1481]

[SPECIAL STUDY OF FUTURES INDUSTRY]

Sec. 23. (a)(1) The Board of Governors of the Federal Reserve System, the Commission, and the Securities and Exchange Commission, with assistance from the Secretary of the Treasury, shall conduct a study of the effects on the economy of trading in contracts of sale of commodities for future delivery and in options (including options on commodities, options on contracts of sale of commodities for future delivery, options on foreign currencies, and options on securities, including exempted securities or on any group or index of securities). The agencies participating in the study may select representative futures contracts and options contracts and representative periods of time for detailed study.

(2) The Board of Governors of the Federal Reserve System shall organize the study and shall do so in such manner that the total cost to all participating agencies of conducting the study is not more than \$3,000,000. To the extent possible, such agencies shall use data which are readily available to them.

(3) among the areas to be studied are—

(A) the effects, if any, that trading in such instruments has on the formation of real capital in the economy (particularly that of a long-term nature) and the structure of liquidity in credit markets;

(B) the economic purposes, if any, served by the trading of such instruments;

(C) the sufficiency of the public policy tools available to regulate such trading activity to avoid harmful economic effects in the markets for such instruments, the underlying cash markets, and related financial markets;

(D) the adequacy of investor protections afforded to participants in the markets for such instruments; and

(E) the extent to which instruments may be utilized to manipulate or profit from the manipulation of, the markets for evidence of indebtedness, foreign currency, and securities.

(4) The Commission shall have primary responsibility for selecting and studying the instruments under its jurisdiction, and the Securities and Exchange Commission shall have primary responsibility for selecting and studying the instruments under its jurisdiction.

APACHE CORPORATION
1900 One United Bank Center
1700 Lincoln Street
Denver, CO 80203-4519

STATEMENT OF

JOHN A. KOCUR

on behalf of
APACHE CORPORATION

for the

COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE

Concerning S.1523
and
THE ISSUE OF PRIVATE CIVIL RICO

STATEMENT OF
JOHN A. KOCUR, PRESIDENT
on behalf of
APACHE CORPORATION
for the
COMMITTEE ON THE JUDICIARY
UNITED STATES SENATE
Concerning S.1523 and
THE ISSUE OF PRIVATE CIVIL RICO

Mr. Chairman and Members of the Committee, we at Apache Corporation thank you for affording us the opportunity to submit this statement concerning Senate Bill 1523 and the issue of private rights of action under Title 18 U.S.C. § 1961 et seq., The Racketeer Influenced and Corrupt Organizations Act ("RICO").

Apache Corporation is a publicly held company traded on the New York and Midwestern stock exchanges. Apache is principally engaged in the exploration and production of natural gas and oil in North and South America.

Apache Corporation is the plaintiff in a civil RICO suit in the United States District Court for the Western District of New York, Apache v. McKeen, et al., Civ. No. 79-894 which has been pending since November 2, 1979. Both Senate Bill 1523 and the bill

introduced by Mr. Boucher in the House, H.R. 2983, effectively eliminate the right of legitimate businesses which are victimized by organized criminal activity in furtherance of a bribery conspiracy to bring suit and recover treble damages from all those who engaged in such criminal conduct and conspiracy.

Our concern with Senate Bill 1523 has to do with the broad requirement that there be a prior criminal conviction of a substantive offense under RICO as a condition precedent to a civil suit for treble damages by the victim of the defendant's illegal conduct, and with a provision that would apply such requirement retroactively to pending lawsuits. In our experience, a prior criminal conviction requirement and the retroactivity provision are unprecedented in remedial legislation.

It is ironic that Congress is considering the softening of the statute which deals firmly with "white-collar" crime at the very time that such crimes are at their peak. It was pointed out in testimony before a House Commerce subcommittee that one-half the bank failures and one-quarter of the failures of savings and loan institutions involve serious criminal activity by insiders.

Various business groups such as the National Association of Manufacturers (NAM) have engaged in extensive lobbying efforts in support of legislation that would destroy RICO's treble damage

remedy in private actions involving business plaintiffs. Perhaps because the business victims of sophisticated bribery schemes and other white collar crimes are not organized, their voices may not have been heard.

Apache is a longtime active member of NAM, but we vigorously disagree with the portrayal of RICO as an anti-business statute. In our view, RICO is not anti-business at all; it is simply anti-crime. Apache supports the current RICO statute as a much needed weapon to help combat organized white collar crime and business corruption and to provide appropriate redress to the victims of such illegal activity.

The civil remedies provisions of RICO, 18 U.S.C. §1964(c) were passed by the Congress in 1970 in order to:

"seek the eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime."

(Congressional Statement of Findings and Purpose, reported at 28 U.S.C.A. §1061 et. seq.)

In recent years, various plaintiffs have sought to use RICO

to sue for treble damages against legitimate businesses in product liability suits, breach of contract claims, so-called "garden variety" business disputes and other contexts far removed from the kind of organized criminal activity that lay at the heart of RICO's prohibitions. The attempted - albeit largely unsuccessful - use of RICO in such cases has prompted calls for reform.

However, in other RICO suits brought by business plaintiffs, the claim for treble damages authorized by RICO is grounded on the defendant's organized criminal activity involving bribery and corruption as intended by the statute. There has been and continues to be a great need for the remedies of treble damages and legal fees in such cases. The current RICO statute, in my opinion, is the greatest single deterrent to organized white collar crime today on a business to business level. Furthermore, the treble damage remedy is necessary in order to adequately compensate the victims of massive business frauds and bribery schemes.

The suit filed by Apache presents a classic case in point to demonstrate the appropriate use of the current RICO law in business suits. As set forth in Apache's complaint, this suit alleges massive fraud and corruption through a large scale organized bribery scheme that destroyed the businesses of Seneca Steel Services, Inc. and Beals, McCarthy and Rogers, Inc. two steel service centers located in Buffalo, New York. Prior to July 31, 1975, Seneca and Beals were wholly owned subsidiaries of plaintiff Apache. The complaint alleges that, pursuant to the bribery

conspiracy, approximately \$600,000 in bribes were paid by various vendors of foreign steel to the former President (McKeen) and Vice-President (Barnes) of Seneca and Beals in 75 bribery checks over a three year period in connection with \$20 million in purchases of excessive and defective foreign steel from the bribing vendors.

It is further alleged that the corrupt purchases resulted in a substantial cash drain that threatened the financial stability of Apache and led to the forced liquidation and bulk sale of assets to a third party; that defendants' bribery activity had progressed continuously and without interruption from the beginning of the scheme in 1973 to come to an end only after causing the collapse of Apache's steel business by early 1975; that to provide an organization and structure for this open-ended and corrupt scheme, McKeen, Barnes and Taube secretly organized and operated their trading companies, Diversified Consultants, Lakeside Trading and Cliffside Trading; that these Trading Companies were formed ostensibly as legitimate businesses and enterprises, but were in fact used by McKeen, Barnes, Taube and the defendant vendors as fronts and vehicles to receive and disburse the bribe payments.

It is further alleged that defendant bribing vendors were fully aware of the bribery scheme and that these vendors, who were steel brokers and suppliers of foreign steel, shared a common purpose with McKeen and Taube in joining and participating in the

bribery program. They all sought to do substantial business with Seneca and Beals through systematic bribery and corruption and to profit from on-going organized criminal activity carried out over a three year period from 1973 to 1975 through a central business structure that would launder the bribe funds and prevent discovery.

The above allegations are supported by testimony under oath in depositions of various witnesses taken by Apache and in the proceedings before the Honorable John T. Curtin, U.S. District Judge in McKeen's guilty plea to a charge of criminal conspiracy under §18 U.S.C. Section 371. A copy of the transcript of proceedings in the guilty plea is attached as Exhibit A.

It is the position of Apache that defendant Commercial Metals and the other conspiring vendors knew from the beginning of the scheme in 1973 that they were joining with McKeen and other vendors in a large-scale open-ended bribery program. Defendant Abbott has testified on deposition concerning this issue. Abbott was then Director of Commercial Metals New Steel Trading Division. Marvin Selig was then Executive Vice-President of Commercial Metals Company, one of three members of Commercial Metals' Executive Committee and a member of its Board of Directors. Abbott testified that in 1973, when he sought the approval of Selig to pay "commissions" to McKeen's Trading Companies on sales to Seneca, he made it clear to Selig that other companies were involved in the scheme. Nevertheless, Selig authorized and approved the bribery program, telling Abbott to go ahead with the

business but to "be careful":

"Abbott: " . . . He (Selig) then asked me about whether or not it was a substantial amount of business. I then told him from what I understood from Arno Kahn that he had done business with him (McKeen) before and that there was a substantial amount of business there.

I then told him that other people were involved in commissions and that he had done business with him before and that he had paid him commissions before.

By Apache Counsel:

Q. "He" meaning who?

A. Mr. Kahn. Mr. Kahn before he came to work for us.

Q. What was Mr. Selig's response?

A. He said to go ahead and to report back to him, but to be careful. He said to go ahead with the business."

(Abbott deposition April 26, 1983 at pg. 100).

The Beals and Seneca employees who received the bribes alleged in Apache's complaint (McKeen and Barnes), together with one Sigmund R. Taube, were indicted for conspiracy to violate the Federal Travel Act and The Mail Fraud Statute by arranging with various vendors of steel to Seneca and Beals to be paid bribes on purchases of steel from said vendors. Barnes died while his indictment was pending. McKeen and Taube pleaded guilty to the indictment. Violations of the Travel Act, 18 U.S.C. §1952 et seq. and the Mail Fraud Statute, 18 U.S.C. §1341 are predicate crimes under RICO.

The indictment charges that Commercial Metals, Commercial Steel and Martin Enterprises, (all defendant vendors in the Apache litigation) paid money to McKeen, Barnes and Taube through Diversified Consultants, Lakeside and Cliffside to induce and procure approval by McKeen and Barnes of purchases of steel and to secure the commercial benefits of such transactions. A copy of the indictment is attached as Exhibit B.

In connection with the federal prosecution and grand jury investigation into this scheme, the U.S. attorney gave grants of immunity from prosecution to various employees and officers of several vendors, including Commercial Metals, in exchange for their testimony which was used to indict and convict Messrs. McKeen and Taube. Although named as co-conspirators in the indictment, none of the vendor corporations were separately indicted or convicted.

Organized bribery schemes such as that which victimized Apache present a serious threat to our economic and social system. Others have documented the extent and effects of bribery, corruption and organized crime on the U.S. economy. According to the U.S. Chamber of Commerce study, White Collar Crime: Everybody's Problem, Everybody's Loss (1974), the economic loss resulting from kickbacks, payoffs and commercial bribes in the U.S. is between three and six billion dollars annually, and some experts suggest that the real costs of kickbacks and bribes are closer to twenty to thirty billion dollars per year. See U.S. News and World

Report, October 29, 1973 at p. 38. The direct economic costs associated with these and other fraudulent schemes is estimated between 44 to 100 billion dollars annually. See G.R. Blakey, Private Civil Suits Under RICO, 1984 RICO Litigation Reporter at 488, quoting testimony of William Webster, Hearings on the Dept. of State, Justice, Commerce, Judiciary and related agencies, Subcommittee on Appropriations, House of Representatives, 96th Congress 2d. Session p. 17 (1980).

The treble damage remedy afforded to victims of such corrupt practices by the current RICO statute embodies the private attorney general concept central to the anti-trust laws and other federal statutes aimed at pervasive national economic problems. The private enforcement remedy is necessary to supplement government prosecutors and agencies whose resources are too limited to combat the increasing amount of white collar crime. Furthermore, as Anthony J. Celebrezze, Attorney General for the State of Ohio, testified before the Subcommittee on Criminal Justice, House Judiciary Committee, 99th Congress, 1st Session, October 9, 1985: "[b]usiness crime is best fought by those most familiar with it -- the businessmen, employees, and private consumers who have been victims of it."

And as G. Robert Blakey put it:

"Public Enforcement with its principal reliance on the criminal law cannot be relied upon to do the whole job of policing fraud. As former Supreme Court Justice Robert H. Jackson observed, 'the criminal law has long

proved futile to reach the subtler kinds of fraud at all, and able to reach grosser fraud, only rarely.' (citation omitted)

We must, in short, be candid about the limitations of the criminal justice system in the white-collar crime area. Resources available for investigation and prosecution are scarce. The common law criminal trial is ponderous. The cases are complex. Offenders will be most often treated as "first offenders" even if they had actually engaged in a pattern of behavior over a substantial period of time. A few convictions will yield only a minimal deterrent effect."

Blakey, Civil RICO, National Law Journal, August 3, 1987.

The benefits to the public that result from the private enforcement of civil suits by business victims of white collar crime are real. Apache has been victimized by the bribery of its employees in connection with the steel businesses in Buffalo, and also in connection with Apache's oil business in Oklahoma. In the early 1980's, Apache learned of the possible bribery of its employees in Oklahoma who worked in the oil industry. As a matter of corporate responsibility, Apache conducted private investigations and filed civil damage suits which were instrumental in obtaining tougher laws against commercial bribery in Oklahoma, and aided law enforcement efforts to root out extensive corruption in the industry. Writing for the U.S. Department of Justice, Western District of Oklahoma in a letter dated December 10, 1985, (copy attached as Exhibit C), U.S. Attorney William S. Price formally

recognized Apache's contribution to the fight against white collar crime:

" I would like to express my appreciation for the tremendous leadership which you [Raymond Plank, Apache Board Chairman] and your company [Apache] have exhibited in the cleaning up of corruption in the oil industry of this state. The lawsuits initiated by your attorneys based on the information your employees and investigators have uncovered have done more to promote ethical conduct in this industry than any efforts of prosecutors in the last ten years.

I consider the billions of dollars lost through commercial bribery in the oil industry as one of the most important white collar crimes in this country, adding 30% to 40% to the cost of drilling each well and thereby cheating the consumers of oil products, royalty and working interest owners as well and the stockholders of companies such as your own. The publicity on your cases helped me to get the Commercial Bribery Statute passed in the state of Oklahoma and hopefully will help to reform the state prosecutorial system.

During the next year, our office along with the FBI and the IRS Criminal Investigation Division will be trying our best to build upon the groundwork of your efforts and although these cases are difficult to detect, you have provided us with the information needed to begin this effort. I realize that Apache has probably spent more in attorney and investigative fees than would normally be justified if only Apache's interests were considered.

It is very gratifying to us in law enforcement to know that a corporation such as Apache is willing to take actions to clean up this pervasive corruption that undermines our free enterprise system and corrupts many individuals involved in this industry."

Richard A. Posner, Judge of the Seventh Circuit Court of Appeals and distinguished legal scholar, has further detailed the

need for private enforcement mechanisms of more than actual damages against deliberate fraud and criminal conduct, particularly where the factor of concealment is present. See R. Posner, Economic Analysis of Law § 7.2 (2d. Ed. 1977) at 462; 143; 272; 235: Actual damages for deliberate fraud tell the perpetrator that if he is caught, he will only have to give the loot back. If he is not, he may keep it; and even if he is sued, he may be able to defeat part of the damage claim or be able to compromise it. Without treble damage remedies, there are few economic disincentives to those who engage in deliberate criminal conduct.

Furthermore, treble damages serve to provide just and equitable compensation to the victims of organized criminal conduct. Seldom, if ever, can victims of conspiracies such as took place here quantify the total losses sustained by reason of the defendants' illegal conduct.

Again, the current Apache suit is a case in point. After years of litigation, Apache is still attempting to recover for dollars lost in 1974 and 1975. And, Apache is unable to prove the full extent of its losses because various business records of Seneca and Beals in 1974 and 1975 are no longer available and because it is difficult to quantify lost opportunity costs and other consequential damages sustained by business victims of pervasive corruption. Without the ability to sue and recover automatic treble damages in cases like this, business victims of organized corruption would seldom, if ever, obtain full compen-

sation for their actual damages, taking into account the time-consuming effort, expense and difficulty of investigating and successfully prosecuting private actions against organized criminal activity.

In his statement introducing Senate Bill 1523, Senator Metzenbaum explicitly stated that:

"While civil RICO has been abused, it has also served the critical function of aiding victims of systematic criminal behavior. Governments, consumers, and even businesses are counted among these victims who have relied on civil RICO to seek compensation for losses

* * *

Suits by businesses to recover losses incurred due to arson, criminal fraud, and bribery schemes should also be counted among the worthwhile applications of civil RICO.

These uses of civil RICO should continue. This is especially so because civil RICO often represents the only meaningful avenue of recovery in these cases.

The goal of this bill is to prevent the abusive uses while preserving the appropriate uses of civil RICO. . . ."

Unfortunately, in the effort to curb perceived abusive uses of RICO, S. 1523 would gut the current statute, even as applied to organized business corruption and bribery cases such as the Apache case. This result is unnecessary, unwise and unjust.

If the RICO statute were amended to require a prior criminal conviction of RICO or of a substantive offense before a business plaintiff could sue for treble damages, and such legislative amendment were applied retroactively to pending lawsuits, then the

defendant vendors in the current Apache suit would undoubtedly seek dismissal of the RICO claims as to them on the basis that the corporate vendors themselves have not been indicted or convicted of any crime. And, even McKeen and Taube, who were convicted of conspiracy to commit bribery, would seek dismissal on the basis that a conspiracy conviction is technically not a conviction under RICO nor a conviction of a substantive RICO offense, but one under 18 U.S.C. § 371, the statute making it a crime to conspire to violate any federal criminal statute.

The prior conviction requirement is fundamentally at odds with the central purpose of RICO's private civil remedy and has no rational justification. As Supreme Court Justice White put it:

"Such a rule would severely handicap potential plaintiffs. A guilty party may escape conviction for any number of reasons - not least among them the possibility that the Government itself may choose to pursue only civil remedies. Private attorney general provisions such as § 1964(c) are in part designed to fill prosecutorial gaps. Cf. Reiter v. Sonotone Corp., 442 U.S. 330, 344 (1979). This purpose would largely be defeated, and the need for treble damages as an incentive to litigate unjustified, if private suits could be maintained only against those already brought to justice." Sedima, S.P.R.L. v. Imrex Co., Inc., 105 S. Ct. 3275 (1985).

Additional problems presented by a prior conviction requirement include the following: (a) unindicted co-conspirators or defendants granted immunity under 18 U.S.C. § 6003 would be immune from liability under RICO; (b) felony offenders frequently plead to lesser charges; (c) additional pressures will be brought on

prosecutors in the plea bargaining process; (d) the credibility of witnesses in criminal prosecutions may be attacked if such witnesses are potential RICO plaintiffs; and (e) the practical inability to obtain criminal convictions of corporations who engage in corrupt practices, since most government law enforcement efforts are directed at individuals, rather than corporations.

The extraordinary proposal for retroactive application of a prior conviction requirement would be particularly unfair and harsh as to Apache when viewed in light of the defendants' stonewalling and obstructive tactics which have been responsible for long delays in the current lawsuit. To briefly summarize the procedural history, Apache filed suit against McKeen and Barnes in New York State Supreme Court in January, 1978, nearly ten years ago. Between February, 1978 and September, 1979, a period of one and one-half years, McKeen and Barnes prevented plaintiffs from finding out about the bribery activity through perjured testimony, opposition to discovery motions and the destruction of records.

When plaintiffs finally discovered the bribery activity as a result of court ordered discovery from third parties, including banks and independent accountants, plaintiffs promptly filed the current federal lawsuit on November 2, 1979.

The Federal grand jury began its criminal investigation one month later, in December, 1979, on the basis of information supplied by Apache's counsel. The grand jury investigation continued until June, 1981. During that one and one-half year

period, plaintiffs were unable to progress the civil lawsuit because the various defendants were invoking their rights under the fifth amendment against self incrimination and refused to cooperate in any discovery.

Following the discharge of the grand jury in June, 1981 and the criminal convictions of McKeen and Taube on the indictment, in June, 1982, plaintiffs were able to take the testimony upon deposition of the major participants in the payments of "commissions". McKeen and Taube finally confessed to their illegal activities and criminal conduct on plaintiffs depositions in 1982 and 1983 when they could no longer plead the fifth amendment. Plaintiffs completed discovery by mid 1984 of multiple other parties and witnesses essential to this complex case.

In July, 1984, the United States Court of Appeals for the Second Circuit in the Sedima case ruled that a private civil RICO plaintiff must plead and prove a prior criminal conviction before he could bring suit under RICO. Following the Second Circuit's decision, the defendant vendors filed motions to dismiss based on the Sedima prior criminal conviction requirement. The Court reserved decision on those motions pending review of the Sedima case by the United States Supreme Court. In July, 1985, a year later, the Supreme Court reversed the Second Circuit in Sedima on the prior criminal conviction issue. The various dismissal motions made by defendants in our case were then denied.

Thereafter, between September, 1985 and August, 1986,

various defendants took up further time by conducting multiple depositions of over forty present and ex-employees of Apache, most of whom had little or no direct involvement in the operations of Apache's Metals Division.

Following the completion of their deposition program, the various defendants have filed more than a dozen motions for partial summary judgment or dismissal on various grounds. These motions have been pending since October, 1986. The trial judge held oral argument in July, 1987, but has not yet ruled on the motions or set a trial date. In our opinion, the motions at best raise issues of fact that only a jury can decide, and quite probably the motions were filed solely for the purpose of further delay in the hope that RICO would be emasculated by a retroactive amendment.

As matters stand today, it has been ten years after suit was first filed against McKeen and various defendants are still engaging in delay tactics. Under all the circumstances of this case, it would be a miscarriage of justice if the defendants were finally able to profit by a retroactive legislative amendment to RICO that would impose a prior criminal conviction requirement.

Temple University is also a plaintiff in a pending civil RICO suit arising out of a bribery scheme. Like the Apache case, Temple University has sued to recover damages resulting from bribes allegedly paid to its employees by various suppliers. In the Temple case, too, the bribing suppliers were granted immunity from

prosecution by the government in exchange for testimony used to indict and convict the Temple employees who received the bribes. Yet, because Temple is a not-for-profit corporation, Temple's pending RICO suit against the bribing vendors would be exempt from the retroactive application of a prior conviction requirement under the terms of a specific provision included in S. 1523. If the retroactive application of S. 1523 is expressly acknowledged by the Committee to be an injustice to a not-for-profit corporation, such is no less an injustice when applied to a public corporation which has been victimized by similar corrupt conduct.

Apache has, at great expense exceeding \$2,000,000 and untold staff time, diligently pursued independent investigation and civil lawsuits to prosecute its claim for damages resulting from organized criminal conduct. The criminal indictments, prosecutions and ultimate convictions obtained were the direct result of Apache's efforts. It is illogical and unjust to now condition Apache's right to damages from the parties paying so-called "commissions" under RICO on a requirement of a prior criminal conviction as to each corporate member of the alleged conspiracy.

It would be a rare criminal conspiracy case indeed, involving multiple corporate and individual conspirators, where the government would not offer and grant immunity from criminal prosecution to certain co-conspirators, or enter into plea arrangements with others to lesser crimes than RICO, in order to establish its criminal case against the central figures and major targets of its

prosecution.

The requirement of a prior criminal conviction to support a civil RICO case would make a valid civil RICO claim entirely dependent upon the discretion, the willingness, the ability and the success of a prosecutor who may or may not decide to indict under RICO and prosecute the charge through a complex trial. Had there been such a condition precedent to a civil RICO suit for treble damages in 1979, the criminal investigation and the parties charged may have been approached differently. Had Apache known at the time of such condition precedent, we would have sought a mandamus to compel the U.S. Attorney to prosecute all parties under RICO. See, In Re Grand Jury Application, (S.D.N.Y. April 26, 1985, where a civil RICO plaintiff was granted such mandamus.) Under these circumstances the proposed retroactive application of S. 1523 is grossly unfair, if not unconstitutional.

Any perceived abuses of civil RICO can and should be curtailed by targeted reform measures such as the House bill introduced by Representative John Conyers, Jr. The Conyers bill would eliminate the inappropriate use of civil RICO while preserving the statute's enhanced remedies for the victims of real criminal conduct.

We respectfully urge you to take into account the concerns we have expressed here for the rights of businesses which have been victimized by organized criminal activity. Now is not the time to weaken existing laws against white collar crime. We are deeply

concerned that legislation such as S. 1523 will send exactly the wrong message to those who would engage in sophisticated criminal schemes, especially if such legislation is made retroactive. In today's business climate, the need for an effective deterrent to large scale organized business corruption, bribery or other criminal conduct has never been greater.

Respectfully submitted,

John A. Kocur, President
Apache Corporation

Calendar No. 875

100TH CONGRESS
2D SESSION

S. 1523

[Report No. 100-459]

To amend chapter 96 of title 18, United States Code.

IN THE SENATE OF THE UNITED STATES

JULY 22 (legislative day, JUNE 23), 1987

Mr. METZENBAUM (for himself and Mr. DURENBERGER) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

AUGUST 8 (legislative day, AUGUST 5), 1988

Reported by Mr. BYRD (for Mr. BIDEN), with an amendment

[Strike out all after the enacting clause and insert the part printed in italic]

A BILL

To amend chapter 96 of title 18, United States Code.

- 1 *Be it enacted by the Senate and House of Representa-*
 2 *tives of the United States of America in Congress assembled,*
 3 ~~SECTION 1. PATTERN OF UNLAWFUL ACTIVITY.~~
 4 ~~(a) CHAPTER 96 HEADING.~~—The heading for chapter
 5 96 of title 18, United States Code, is amended by striking out
 6 “RACKETEER INFLUENCED AND CORRUPT

1 **ORGANIZATIONS"** and inserting in lieu thereof **"PAT-**
2 **TERN OF UNLAWFUL ACTIVITY"**.

3 (b) **SECTION 1961.**—Section 1961 of title 18, United
4 States Code, is amended—

5 (1) in paragraph (1), by striking out "racketeer-
6 ing" the first place it appears and inserting "unlawful"
7 in lieu thereof;

8 (2) in paragraph (5), by striking out "racketeer-
9 ing" each place it appears and inserting "unlawful" in
10 lieu thereof;

11 (3) in paragraph (7), by striking out "racketeer-
12 ing" each place it appears and inserting "criminal" in
13 lieu thereof; and

14 (4) in paragraph (8)—

15 (A) by striking out "racketeering" the first
16 place it appears and inserting "unlawful activity"
17 in lieu thereof; and

18 (B) by striking out "racketeering" the second
19 place it appears and inserting "criminal" in lieu
20 thereof.

21 (c) **SECTION 1962.**—Section 1962 of title 18, United
22 States Code, is amended by striking out "racketeering" each
23 place it appears and inserting "unlawful" in lieu thereof.

1 (d) SECTION 1962.—Paragraph (2) of section 1962(a) of
2 title 18, United States Code, is amended by striking out
3 “racketeering” and inserting “unlawful” in lieu thereof.

4 (e) SECTION 1968.—Section 1968 of title 18, United
5 States Code, is amended—

6 (1) in subsection (a), by striking out “a racketeer-
7 ing investigation” and inserting “an unlawful activity
8 investigation” in lieu thereof;

9 (2) in subsection (b), by striking out “racketeer-
10 ing” each place it appears and inserting “unlawful ac-
11 tivity” in lieu thereof;

12 (3) in subsection (c), by striking out “racketeer-
13 ing” each place it appears and inserting “unlawful
14 activity” in lieu thereof; and

15 (4) in subsection (f)—

16 (A) by striking out “racketeering” the first,
17 second, and fifth places it appears and inserting
18 “criminal” in lieu thereof;

19 (B) by striking out “racketeering” each other
20 place it appears and inserting “unlawful activity”
21 in lieu thereof; and

22 (C) by striking out “racketeer” and inserting
23 “unlawful activity” in lieu thereof.

1 **SEC. 2. CIVIL RECOVERY.**

2 Subsection (c) of section 1064 of title 18, United States
3 Code, is amended to read as follows:

4 “(c)(1)(A) A governmental entity whose business or
5 property is injured by conduct in violation of section 1062 of
6 this title may bring, in any appropriate United States district
7 court, a civil action therefor and shall recover threefold the
8 actual damages to the business or property of the govern-
9 mental entity sustained by reason of such violation, and the
10 costs of the civil action, including a reasonable attorney’s fee.

11 “(B) A civil action under subparagraph (A) of this para-
12 graph must be brought by—

13 “(i) the Attorney General, if the injury is to the
14 business or property of the United States;

15 “(ii) the chief legal officer of a State, if the injury
16 is to the business or property of the State;

17 “(iii) the chief legal officer of a unit of general
18 local government of a State, if the injury is to the busi-
19 ness or property of the unit of general local govern-
20 ment; or

21 “(iv) the court-appointed trustee, if the injury is to
22 the business or property of an enterprise for which a
23 trustee has been appointed by a United States district
24 court under section 1064(a) of this title.

25 “(2) A person whose business or property is injured by
26 conduct in violation of section 1062 of this title may bring, in

1 any appropriate United States district court, a civil action
2 therefor and shall recover—

3 “(A) threefold the actual damages to the person’s
4 business or property sustained by reason of such viola-
5 tion, and the costs of the civil action, including a rea-
6 sonable attorney’s fee, if the person who engaged in
7 the conduct was, with respect to such conduct, convict-
8 ed of an unlawful activity or of a violation of section
9 1962 of this title; or

10 “(B)(i) the actual damages to the person’s busi-
11 ness or property sustained by reason of such violation,
12 and the costs of the civil action, including a reasonable
13 attorney’s fee; and

14 “(ii) punitive damages of up to twice the actual
15 damages, if—

16 “(I) the person whose business or property is
17 injured is a governmental entity other than a unit
18 of general local government; or

19 “(II)(aa) the person whose business or prop-
20 erty is injured is a natural person and the injury
21 occurred in connection with a purchase or lease,
22 for personal or household use or investment, of a
23 product, service, investment, or other property, or
24 a contract for personal or household use or invest-
25 ment;

1 “(bb) neither State nor Federal securities
2 laws make available an express or implied remedy
3 for the type of behavior on which the claim of the
4 plaintiff is based, unless the plaintiff was injured
5 by conduct proscribed by section 21(d)(2)(A) of the
6 Securities Exchange Act of 1934 (15 U.S.C.
7 78u(d)(2)(A)) or unless the plaintiff is a small in-
8 vestor; and

9 “(cc) the plaintiff proves by clear and con-
10 vincing evidence that the defendant acted in con-
11 scious and wanton disregard of the consequences
12 of the defendant's actions to the plaintiff.

13 “(2) In a civil action involving a claim for punitive dam-
14 ages under paragraph (2)(B) of this subsection, the trier of
15 fact, in determining the amount of punitive damages, shall
16 consider—

17 “(A) the degree of culpability of the defendant;

18 “(B) the degree of disparity in the bargaining po-
19 sitions of the plaintiff and the defendant;

20 “(C) any history of similar conduct by the
21 defendant;

22 “(D) the benefits derived from the unlawful con-
23 duct by the defendant;

24 “(E) the number of persons victimized;

1 “(F) any prior decision by a court or State or
2 Federal agency as to whether the defendant’s conduct
3 giving rise to the action violated applicable law or con-
4 stituted bad faith;

5 “(G) the extent to which the class action aspect
6 of the compensatory damage award fulfills the deter-
7 rent function of punitive damages; and

8 “(H) any other factor the court deems to be an
9 equitable consideration bearing on the appropriate
10 amount of punitive damages.

11 “(4)(A) A civil action under this subsection may not be
12 commenced after the latest of—

13 “(i) three years after the date the cause of action
14 accrues;

15 “(ii) three years after the conduct causing injury
16 to the plaintiff terminates; or

17 “(iii) two years after the date of the criminal con-
18 viction required for an action under paragraph (2)(A) of
19 this subsection.

20 “(B) The period of limitation provided in subparagraph
21 (A) of this paragraph on a cause of action does not run during
22 the pendency of a government civil action or criminal case
23 relating to the conduct upon which such cause of action is
24 based.

1 “(5) It shall be an affirmative defense to an action
2 brought under this subsection that the defendant acted in
3 good faith and in reliance upon a directly applicable regula-
4 tory action, approval, or interpretation of law by an author-
5 ized State agency. Before the commencement of full discov-
6 ery on and consideration of the plaintiff's claim, the court
7 shall determine, upon defendant's motion, the availability of
8 any affirmative defense asserted under this paragraph, pro-
9 vided that discovery of such defense shall be allowed, as pro-
10 vided by law or rule of procedure, prior to the court's
11 determination.

12 “(6) In an action under this subsection, evidence rele-
13 vant only to the amount of punitive damages shall not be
14 introduced until after a finding of liability, except the court
15 may permit, for good cause shown, introduction of such evi-
16 dence prior to a finding of liability on motion of a party or in
17 the exercise of its discretion.

18 “(7) In a civil action under this subsection, the court,
19 upon motion, shall award a reasonable attorney's fee if—

20 “(A) the claim was frivolous, unreasonable, or
21 groundless when asserted; or

22 “(B) the party asserting the claim continues to
23 litigate after the claim is proven to be clearly frivolous,
24 unreasonable, or groundless.

1 “(8) In an action under this subsection, facts supporting
2 the claim against each defendant shall be averred with
3 particularity.

4 “(9)(A) As used in this subsection—

5 “(i) the term ‘governmental entity’ means
6 the United States or a State, and includes any de-
7 partment, agency, or government corporation of
8 the United States or a State, any political subdivi-
9 sion of a State, and any enterprise for which a
10 trustee has been appointed by a United States dis-
11 trict court under section 1964(a) of this title (but
12 only during the tenure of such trustee);

13 “(ii) the term ‘small investor’ means a natu-
14 ral person who, at the time the cause of action
15 arises, either—

16 “(I) owned securities, excluding securi-
17 ties constituting investments in pooled in-
18 vestment funds that invest substantially all
19 their assets in short-term debt instruments
20 and maintain a stable net asset value or in
21 United States debt instruments, valued at
22 less than or equal to the median portfolio
23 value of all United States securities holders
24 of such securities; or

1 “(II) was a member of a household with
2 an annual income of less than or equal to the
3 United States median household income; and
4 “(iii) the term ‘security’, unless otherwise
5 specifically provided in this Act, shall have the
6 same meaning given to such term under the Secu-
7 rities and Exchange Act of 1934 except that such
8 term shall only include instruments that comply
9 with the requirements of the Securities and Ex-
10 change Act of 1934.

11 “(B)(i) For purposes of subparagraph (A)(ii), the Securi-
12 ties and Exchange Commission shall publish annually a
13 survey that describes the securities holdings of natural per-
14 sons in the United States. Such survey shall indicate the
15 median portfolio value of all natural persons in the United
16 States who own securities, excluding securities constituting
17 investments in pooled investment funds that invest substan-
18 tially all their assets in short-term debt instruments and
19 maintain a stable net asset value or in United States debt
20 instruments.

21 “(ii) The median portfolio value of all United States se-
22 curities holders for years prior to the enactment of this Act
23 shall be deemed to be the median portfolio value of all United
24 States securities holders for the first year after enactment of

1 this Act as indicated by the Securities and Exchange Com-
2 mission's survey."

3 **SEC. 2. EFFECTIVE DATE.**

4 (a) **GENERAL RULE.**—The amendments made by this
5 Act shall apply to any civil action commenced after the date
6 of enactment.

7 (b) **EXCEPTION.**—In any pending action under section
8 1964(e) of title 18, United States Code, in which a person
9 would be eligible to recover only under paragraph (2)(B)(i) of
10 section 1964(e) as amended by this Act, if this Act had been
11 enacted before the commencement of that action, the recov-
12 ery of that person shall be limited to the recovery provided
13 under such paragraph (2)(B)(i), unless in the pending
14 action—

15 (1) there has been a jury verdict or district court
16 judgment, establishing the defendant's liability, or set-
17 tlement has occurred;

18 (2) the plaintiff is a charitable corporation or a
19 non-profit government chartered corporation; or

20 (3) the court determines that, in light of all the
21 circumstances, such limitation of recovery would be
22 clearly unjust.

1 **SECTION 1. BURDEN OF PROOF.**

2 Section 1964(a) of title 18, United States Code, is
3 amended by inserting after "of this chapter by issuing" the
4 following: "; upon proof by a preponderance of the evidence,".

5 **SEC. 2. CIVIL RECOVERY.**

6 Subsection (c) of section 1964 of title 18, United States
7 Code, is amended to read as follows:

8 "(c)(1)(A) A governmental entity, excluding a unit of
9 local government other than a unit of general local govern-
10 ment, whose business or property is injured by conduct in
11 violation of section 1962 of this title may bring, in any ap-
12 propriate United States district court, a civil action therefore
13 and, upon proof by a preponderance of the evidence, shall
14 recover threefold the actual damages to the business or prop-
15 erty of the governmental entity sustained by reason of such
16 violation, and the costs of the civil action, including a reason-
17 able attorney's fee.

18 "(B) A civil action under subparagraph (A) of this
19 paragraph must be brought by—

20 "(i) the Attorney General or other legal officer
21 authorized to sue, if the injury is to the business or
22 property of the United States;

23 "(ii) the chief legal officer of a State, if the injury
24 is to the business or property of the State;

25 "(iii) the chief legal officer, or other legal officer
26 authorized to sue, of a unit of general local government

1 of a State, if the injury is to the business or property
2 of the unit of general local government; or

3 “(iv) the court-appointed trustee, if the injury is
4 to the business or property of an enterprise for which a
5 trustee has been appointed by a United States district
6 court under section 1964(a) of this title.

7 “(2) A person whose business or property is injured by
8 conduct in violation of section 1962 of this title may bring, in
9 any appropriate United States district court, a civil action
10 therefore and, upon proof by a preponderance of the evidence,
11 shall recover—

12 “(A) the actual damages to the person’s business
13 or property sustained by reason of such violation, and
14 the costs of the civil action, including a reasonable at-
15 torney’s fee; and

16 “(B) punitive damages of up to twice the actual
17 damages, if—

18 “(i)(I) the person whose business or property
19 is injured is a unit of local government other than
20 a unit of general local government; and

21 “(II) the plaintiff proves by clear and con-
22 vincing evidence that the defendant acted in con-
23 scious and wanton disregard of the consequences
24 of the defendant’s actions to the plaintiff;

1 “(ii)(I) the person whose business or proper-
2 ty is injured is a natural person, or an organiza-
3 tion meeting the definition of exempt organiza-
4 tions under section 501(c)(3) of the Internal Rev-
5 enue Code of 1986 (26 U.S.C. 501(c)(3)), an or-
6 ganization meeting the definition of an indenture
7 trustee under the Trust Indenture Act of 1939
8 (15 U.S.C. 77jjj et seq.), an organization meeting
9 the definition of a pension fund under the Em-
10 ployee Retirement Income Security Act (29
11 U.S.C. 1001 et seq.), or an organization meeting
12 the definition of an investment company under the
13 Investment Company Act of 1940 (15 U.S.C.
14 80a-1 et seq.);

15 “(II) the person is injured by conduct pro-
16 scribed by section 21(d)(2)(A) of the Securities
17 Exchange Act of 1934 (15 U.S.C. 78u(d)(2)(A)),
18 subject to the condition that the calculation of pu-
19 nitive damages shall be consistent with section
20 21(d)(2)(C) of the Securities Exchange Act of
21 1934 (15 U.S.C. 78u(d)(2)(C)), and that the as-
22 sessment of punitive damages against a person
23 employing another person who is liable under this
24 clause shall be consistent with section 21(d)(2)(B)

1 *of the Securities Exchange Act of 1934 (15*
2 *U.S.C. 78u(d)(2)(B)); and*

3 *“(III) the plaintiff proves by clear and con-*
4 *vincing evidence that the defendant acted in con-*
5 *scious and wanton disregard of the consequences*
6 *of the defendant’s actions to the plaintiff; or*

7 *“(iii)(I) the person whose business or proper-*
8 *ty is injured is a natural person and the injury*
9 *occurred in connection with a purchase or lease,*
10 *for personal or noncommercial use or investment,*
11 *of a product, service, investment, or other proper-*
12 *ty, or a contract for personal or noncommercial*
13 *use or investment;*

14 *“(II) neither State nor Federal securities or*
15 *commodities laws make available an express or*
16 *implied remedy for the type of behavior on which*
17 *the claim of the plaintiff is based; and*

18 *“(III) the plaintiff proves by clear and con-*
19 *vincing evidence that the defendant acted in con-*
20 *scious and wanton disregard of the consequences*
21 *of the defendant’s actions to the plaintiff.*

22 *“(3) In a civil action involving a claim for punitive*
23 *damages under paragraph (2)(B) of this subsection, the trier*
24 *of fact, in determining the amount of punitive damages, shall*
25 *consider—*

1 “(A) the degree of culpability of the defendant;

2 “(B) the degree of disparity in the bargaining po-
3 sitions of the plaintiff and the defendant;

4 “(C) any history of similar conduct by the
5 defendant;

6 “(D) the benefits derived from the unlawful con-
7 duct by the defendant;

8 “(E) the number of persons victimized;

9 “(F) any prior decision by a court or State or
10 Federal agency as to whether the defendant’s conduct
11 giving rise to the action violated applicable law or con-
12 stituted bad faith;

13 “(G) the extent to which the class action aspect of
14 the compensatory damage award fulfills the deterrent
15 function of punitive damages; and

16 “(H) any other factor the court deems to be an eq-
17 uitable consideration bearing on the appropriate
18 amount of punitive damages.

19 “(4) A person who suffers bodily injury by reason of
20 any conduct in violation of section 1962 of this title that
21 includes a crime of violence as a predicate act may bring a
22 civil action in an appropriate United States district court,
23 and, upon proof by a preponderance of the evidence, shall, as
24 allowed under applicable State law, recover the actual dam-
25 ages sustained by reason of such violation (excluding pain

1 *and suffering) and punitive damages of up to twice the actual*
2 *damages, as well as the costs of the civil action, including a*
3 *reasonable attorney's fee.*

4 “(5) *A person whose business or property is injured by*
5 *conduct in violation of section 1962 of this title may bring, in*
6 *any appropriate United States district court, a civil action*
7 *therefore and, upon proof by a preponderance of the evidence,*
8 *shall recover threefold the actual damages to the person's*
9 *business or property sustained by reason of such violation,*
10 *and the costs of the civil action, including a reasonable attor-*
11 *ney's fee, if the person who engaged in the conduct was, with*
12 *respect to such conduct, convicted of a racketeering activity or*
13 *of a violation of section 1962 of this title.*

14 “(6)(A) *Except as provided in subparagraph (B), a*
15 *civil action under this subsection may not be commenced*
16 *after the latest of—*

17 “(i) *four years after the date the cause of action*
18 *accrues;*

19 “(ii) *four years after the conduct causing injury*
20 *to the plaintiff terminates; or*

21 “(iii) *two years after the date of the criminal con-*
22 *viction required for an action under paragraph (5) of*
23 *this subsection.*

1 “(B) A civil action brought pursuant to subsection
2 (c)(1)(B) (i), (ii), or (iii) may not be commenced after the
3 latest of—

4 “(i) six years after the date the cause of action
5 accrues; or

6 “(ii) four years after the conduct causing injury
7 terminates.

8 “(C) The period of limitation provided in subpara-
9 graphs (A) and (B) of this paragraph on a cause of action
10 does not run during the pendency of a government civil
11 action or criminal case relating to the conduct upon which
12 such cause of action is based.

13 “(7) It shall be an affirmative defense to an action
14 brought under this subsection that the defendant acted in
15 good faith and in reliance upon an official, directly applica-
16 ble regulatory action, approval, or interpretation of law by an
17 authorized Federal or State agency in writing or by oper-
18 ation of law. Before the commencement of full discovery on
19 and consideration of the plaintiff's claim, the court shall de-
20 termine, upon defendant's motion, the availability of any af-
21 firmative defense asserted under this paragraph, provided
22 that discovery of such defense shall be allowed, as provided
23 by law or rule of procedure, prior to the court's
24 determination.

1 “(8) In an action under this subsection, evidence rele-
2 vant only to the amount of punitive damages shall not be
3 introduced until after a finding of liability, except the court
4 may permit, for good cause shown and in the absence of any
5 undue prejudice to the defendant, introduction of such evi-
6 dence prior to a finding of liability on motion of a party or in
7 the exercise of its discretion.

8 “(9) In an action under this subsection, facts support-
9 ing the claim against each defendant shall be averred with
10 particularity.

11 “(10) As used in this subsection:

12 “(A) The term ‘governmental entity’ means the
13 United States or a State, and includes any depart-
14 ment, agency, or government corporation of the United
15 States or a State, any political subdivision of a State,
16 and any enterprise for which a trustee has been ap-
17 pointed by a United States district court under section
18 1964(a) of this title (but only during the tenure of such
19 trustee).

20 “(B) The term ‘charitable corporation’ means a
21 charitable corporation formed under section 501(c)(3)
22 of the Internal Revenue Code of 1986 or a corporation
23 formed under section 501(c)(14)(B) of the Internal
24 Revenue Code of 1986.

1 “(11)(A) *An action or proceeding under this subsection*
2 *shall not abate on the death of the plaintiff or defendant, but*
3 *shall survive and be enforceable by and against his estate and*
4 *by and against surviving plaintiffs or defendants.*

5 “(B) *An action or proceeding under this subsection*
6 *shall survive and be enforceable against a receiver in bank-*
7 *ruptcy but only to the extent of actual damages or other relief.*

8 “(12) *In a civil action under this subsection in which*
9 *the complaint does not allege a crime of violence as a predi-*
10 *cate act—*

11 “(A) *the term ‘racketeer’ shall not be used in re-*
12 *ferring to any party; and*

13 “(B) *the terms used to define conduct in violation*
14 *of section 1962 of this title shall be referred to as fol-*
15 *lows:*

16 “(i) *‘racketeering activity’ as defined in sec-*
17 *tion 1961(1), shall be referred to as ‘unlawful ac-*
18 *tivity’; and*

19 “(ii) *‘pattern of racketeering activity’, as de-*
20 *finied in section 1961(5), shall be referred to as*
21 *‘pattern of unlawful activity’.*

22 “(13) *In a civil action under this subsection in which*
23 *the complaint alleges a crime of violence, the predicate acts*
24 *constituting a crime of violence within the meaning of this*
25 *subsection are offenses involving—*

1 “(A) when chargeable under State law the follow-
2 ing: murder, kidnapping, arson, or robbery;

3 “(B) when accompanied by bodily injury the fol-
4 lowing: extortion as defined by section 1951 of title 18;
5 loansharking and other extortionate credit transactions
6 as defined by sections 891-894 of title 18; obstruction
7 of justice as defined in chapter 73 of title 18; the felo-
8 nious manufacture, importation, receiving, conceal-
9 ment, buying, selling, or otherwise dealing in narcotic
10 or other dangerous drugs, punishable under any law of
11 the United States; or sexual exploitation of children as
12 defined by chapter 110 of title 18; or

13 “(C) destruction of aircraft or aircraft facilities as
14 defined by section 32 of title 18; arson as defined by
15 section 81 of title 18; murder-for-hire as defined by
16 section 1952A of title 18; or homicide as defined by
17 chapter 51 of title 18.”.

18 **SEC. 3. INCREASED PENALTIES FOR HOMICIDE AND MAIMING.**

19 Section 1963(a) of title 18, United States Code, is
20 amended by striking “shall be fined not more than \$25,000
21 or imprisoned not more than twenty years, or both” and in-
22 serting “shall be fined under this title and imprisoned for not
23 more than twenty years (or for life, if the violation is predi-
24 cated on an offense for which the maximum penalty includes
25 life in prison), or both”.

1 **SEC. 4. ADDITIONAL PREDICATE OFFENSES.**

2 Section 1961(1) of title 18, United States Code, is
3 amended—

4 (1) in subparagraph (A), by inserting “prostitu-
5 tion involving minors,” after “extortion,”;

6 (2) in subparagraph (B), by—

7 (A) striking “Section 201” and inserting
8 “Section 32 (relating to destruction of aircraft or
9 aircraft facilities), section 81 (relating to arson),
10 section 201”;

11 (B) inserting before “, section 1084” the fol-
12 lowing: “, section 1029 (relating to fraud and re-
13 lated activity in connection with access devices),”;

14 (C) inserting before “, section 1953” the fol-
15 lowing: “, section 1952A (relating to murder-for-
16 hire)”;

17 (D) inserting before “, section 2320” the fol-
18 lowing: “, section 2318 (relating to counterfeit
19 materials)”;

20 (E) inserting before “, (C)” the following: “,
21 and chapter 51 (relating to homicide), chapter 73
22 (relating to obstruction of justice), and chapter
23 110 (relating to sexual exploitation of children)”;

24 (3) by striking “or” before “(E)”;

25 (4) by striking the semicolon at the end thereof
26 and inserting a comma; and

1 (5) by adding at the end thereof the following:
2 “(F) section 134 of the Truth in Lending Act, or (G)
3 section 5861 of title 26 (relating to firearms control);”.

4 **SEC. 5. FEDERAL JURISDICTION.**

5 Section 1965 of title 18, United States Code, is
6 amended—

7 (1) in subsection (b) by striking “residing in any
8 other district”;

9 (2) in subsection (b) by striking “in any judicial
10 district of the United States by the marshal thereof.”
11 and inserting “anywhere the party may be found.”;

12 (3) in subsection (c) by striking “in any other ju-
13 dicial district” and inserting “anywhere the witness is
14 found”;

15 (4) in subsection (c) by striking “in another dis-
16 trict”; and

17 (5) in subsection (d) by striking “in any judicial
18 district in which” and inserting “where”.

19 **SEC. 6. STATE JURISDICTION.**

20 Chapter 96 of title 18, United States Code, shall not be
21 construed to confer jurisdiction to hear a criminal or civil
22 proceeding or action under its provisions on a judicial or
23 other forum of a State or local unit of government.

1 SEC. 7. EFFECTIVE DATE.

2 (a) GENERAL RULE.—The amendments made by this
3 Act shall apply to any civil action commenced after the date
4 of enactment.

5 (b) EXCEPTION.—In any pending action under section
6 1964(c) of title 18, United States Code, in which a person
7 would be eligible to recover only under paragraph (2)(A) of
8 section 1964(c) as amended by this Act because the person
9 does not meet the requirements of either paragraph
10 (2)(B)(i)(I), paragraph (2)(B)(ii), or paragraphs
11 (2)(B)(iii)(I) and (II) of section 1964(c), if this Act had
12 been enacted before the commencement of that action, the re-
13 covery of that person shall be limited to the recovery provided
14 under such paragraph (2)(A), unless in the pending action—

15 (1) there has been a jury verdict or district court
16 judgment, establishing the defendant's liability, or set-
17 tlement has occurred;

18 (2) the plaintiff is a charitable corporation; or

19 (3) the court determines that, in light of all the
20 circumstances, such limitation of recovery would be
21 clearly unjust.

